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IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.,
Petitioner,

v.

J. J. CURRAN and JACQUELYN L. CURRAN
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Douglas G. Graham, counsel of record
Richard P. Saslow
Seymour M. Nayer
Butzel, Keidan, Simon,
Myers & Graham
1990 First National Building
Detroit, Michigan 48226
(313) 961-7900

Attorneys for Petitioner
Merrill Lynch, Pierce, Fenner,
& Smith, Inc.

Interstate Brief & Record Co., Wurlitzer Bldg., 1509 Broadway, Detroit, MI 48226
962-8745 962-8746

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Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Petitioner, Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch") requests that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Sixth Circuit entered on May 12, 1980.

OPINIONS BELOW

The opinion of the Court of Appeals (A1-A38)[1] is not yet officially reported and is unofficially reported at [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,390. The opinion of the District Court (A39-A49) is not officially reported.

JURISDICTION

The judgment of the Court of Appeals was entered on May 12, 1980. This Court's jurisdiction is invoked under 28 U.S.C. § 1254 (1).

STATUTES INVOLVED

Section 4b of the Commodity Exchange Act, as amended, 88 Stat. 1413, 7 U.S.C. § 6b (1974); Commodity Futures Trading Commission ("CFTC") Reg. § 180.3, 17 C.F.R. § 180.3. Section 4b and other pertinent sections of the Commodity Exchange Act ("CEA") are appended hereto (A52-A57). CFTC Reg. § 180.3 is appended at pages A58-A60.

STATEMENT OF THE CASE

In 1973, respondents J. J. Curran and Jacquelyn L. Curran (the "Currans") opened several commodity trading accounts with Merrill Lynch, a broker of securities and commodities. Upon opening the accounts, the Currans signed agreements to submit to

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[1] "A___" page references are to the Appendix of this Petition.

arbitration disputes that might arise with Merrill Lynch. The commodity trading in the Currans' accounts resulted in losses and the accounts were closed in April, 1974.

In April, 1976, the Currans brought suit for damages in the United States District Court for the Eastern District of Michigan. The Currans alleged violations of sections 5 (failure to register), 12(2) (misleading statements) and 17(a) (fraud) of the Securities Act of 1933 ("1933 Act"), 15 U.S.C. §§ 77e, 77*l*(2), 77q(a); section 15(c)(1) (fraud and rulemaking powers) of the Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C. § 78o(c)(1), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5; and section 4b (fraud) of the CEA, 7 U.S.C. § 6b.[2] The Currans also alleged breaches of duties owed under the Michigan Uniform Securities Act, Rules and Regulations of the National Association of Securities Dealers, the New York Stock Exchange and the Chicago Mercantile Exchange and common law principles of fraud, negligence and contract. Jurisdiction was alleged pursuant to section 22(a) of the 1933 Act, 15 U.S.C. § 77v(a); section 27 of the 1934 Act, 15 U.S.C. § 78aa; sections 1331, 1332 and 1337 of Title 28 of the United States Code; and by virtue of pendent jurisdiction.

Upon Merrill Lynch's motion, the District Court dismissed the Currans' claims under the 1933 and 1934 Acts, and directed the remaining claims to arbitration in accordance with the parties' agreement. In so ruling, the District Court held that the Currans' commodity

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[2] The Complaint alleges activities (fraud) such as are made unlawful by section 4b of the CEA, 7 U.S.C. § 6b. The Complaint actually specifies violation of "Section 6 of the Commodity Exchange Act." Petitioner assumes, however, as did the Court of Appeals (A37) that respondent seeks recovery under CEA section 4b.

trading accounts did not constitute "securities" within the meaning of the 1933 and 1934 Acts and that, upon dismissal of the federal securities claims, there was no impediment to enforcement of the arbitration agreement in accordance with the Federal Arbitration Act, 9 U.S.C. § 3.[3]

The Currans appealed from the District Court's ruling that no cause of action had been stated under the federal securities laws and also argued that the District Court had erred in submitting the dispute to arbitration because the arbitration agreement did not conform to requirements set forth in CFTC Reg. § 180.3. That regulation (A58), effective November 29, 1976, provides that, to be enforceable, arbitration clauses must, *inter alia*, be signed separately and must apprise the customer, in bold-face type, that he may be waiving a right to sue in court. The arbitration agreements signed by the Currans in 1973 do not meet these requirements.

The Court of Appeals unanimously affirmed the District Court's ruling that the Currans' federal securities claims should be dismissed for the reason that no security was involved. The Court also adopted the Currans' argument that CFTC Reg. § 180.3 should be applied retroactively to invalidate the arbitration agreement between the parties. The Court of Appeals then raised, *sua sponte*, the issue of whether a private cause of action exists under the anti-fraud provisions of the CEA. Without benefit of briefing or argument by the parties, a majority of the panel concluded that the CEA provides an *implied* private right of action for

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[3] Merrill Lynch conceded that *Wilko* v. *Swan*, 346 U.S. 427 (1953), precluded enforcement of the arbitration agreement so long as the federal securities claims remained at issue.

fraud. The Court accordingly reversed the District Court's order staying the CEA claims pending arbitration, remanding those claims for trial on the merits.

Judge Phillips dissented, reasoning that Congress' failure expressly to provide a private judicial remedy under the CEA precludes implication of such a right. Judge Phillips relied upon the restrictive approach to implication of private remedies manifest in this Court's recent decisions.

REASONS FOR GRANTING THE WRIT

I. The Court of Appeals' implication of a private right of action for fraud under the Commodity Exchange Act raises an important question of federal law that should be settled by this Court.

The commodities futures market is a risk-shifting mechanism that provides a stabilizing influence on the national economy. An orderly futures market is of paramount importance to producers and commercial users of commodities, to the exchanges, brokers and speculators involved in the market itself, and to the general population which profits by the stabilized availability and price of goods that an orderly futures market promotes.[4]

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[4] S. Rep. No. 93-1131, 93d Cong. 2d Sess. 11-19, *reprinted in* [1974] *U.S. Code Cong. & Ad News* 5843, 5852-60. *See also, Leist* v. *Simplot*, Nos. 79-7402, 7464, 7482 (2d Cir., July 8, 1980) (Slip op. at 4022-28).

The issue presented by this petition involves the balance achieved by Congress in its regulation of the market and the threat posed to that balance by the interjection of judicially created remedies. Moreover, the issue presented by this petition has left the lower federal courts hopelessly divided and it would be consistent with the role of this Court to provide guidance on this question, thereby promoting conservation of judicial resources and sparing those associated with the commodities industry the costs and delay of duplicative litigation.

A. Congress has enacted a comprehensive scheme of commodities regulation which should not be altered by the addition of judicially inferred remedies.

The federal government has been involved in commodities regulation since passage of the Grain Futures Act of 1922. The 1922 Act required grain exchanges to be federally licensed and to assume responsibility for price manipulation by their members.

The degree of regulation provided by the 1922 Act proved inadequate and in 1936 Congress enacted the CEA, broadening federal regulatory and enforcement powers. The scope of coverage was extended to commodities other than grains, to traders and brokers as well as exchanges, and powers were granted to curb excessive speculation by large operators and to prosecute price manipulation as a criminal offense. Section 4b was added to suppress cheating, fraud and fictitious transactions which were impairing the services of the market.[5]

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[5] See, S. Rep. No. 93-1131, 93d Cong. 2d Sess. 14, *reprinted in* [1974] *U.S. Code Cong. & Ad. News* 5843, 5855.

The commodities market has grown dramatically since 1936. A recent report shows the regulated industry now includes 12 existing or proposed exchanges, 329 brokerage firms, 555 money managers, 914 trading advisors and over 31,000 salesmen.[6] In ten years the volume of commodity futures contracts traded has expanded seven-fold and what was previously a business primarily of interest to floor traders and commercial hedgers now involves hundreds of thousands of individual investors[7] and the trading of futures contracts for commodities valued at an estimated $1.5 trillion annually.[8]

Federal regulatory powers have also grown. In 1968 Congress added new commodities to those regulated, increased penalties for certain violations, authorized issuance of cease and desist orders, imposed minimum financial standards on commission merchants and required enforcement by contract markets of their trading rules and contract terms.[9]

Still dissatisfied with the performance of the commodities futures markets and the adequacy of regulatory protection,[10] Congress responded in 1974

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[6] Remarks of Philip F. Johnson, Chairman, ABA Committee on Commodities Regulation, 35 Bus. Law. 691 (Special Issue) (March, 1980).

[7] Remarks of Hon. James M. Stone, Chairman, Commodity Futures Trading Commission, *Id.* at 692.

[8] Wall St. J., Jan. 9, 1979, at 38, col. 5 (estimate for 1978).

[9] S. Rep. No. 93-1131, 93d cong. 2d Sess. 14, *reprinted in* [1974] *U.S. Code Cong. & Ad. News* 5843, 5855.

[10] *Id.*, [1974] *U.S. Code Cong. & Ad. News* at 5856.

with sweeping revisions of the CEA. These amendments, entitled the Commodity Futures Trading Commission Act of 1974 ("1974 Amendments") created the CFTC[11] and explicitly vested this new agency with "*exclusive* jurisdiction" over regulation of commodity futures trading.[12]

The CFTC was created to assure that a single expert agency would have responsibility for developing a coherent regulatory program encompassing futures trading and related activities.[13] Fulfillment of the CFTC's mandate was facilitated by other provisions of the 1974 Amendments which further strengthened regulatory control over the commodities markets. For example, the CFTC was given authority to seek injunctive relief restraining any person from violating the CEA,[14] and to impose against registered persons, after hearing, a civil penalty of up to $100,000 for each violation of the Act.[15]

A prominent feature of the 1974 Amendments was provision for reparation proceedings before the CFTC to adjudicate customer complaints against registered persons, including brokers such as Merrill Lynch.[16] A

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[11] Section 2(a)(2)-(11), 7 U.S.C. § 4a(a)-(j).

[12] Section 2(a)(1), 7 U.S.C. § 2 (emphasis added).

[13] S. Rep. No. 95-850, 95th Cong., 2d Sess. 13, *reprinted in* [1978] *U.S. Code Cong. & Ad. News* 2087, 2101.

[14] Section 6c, 7 U.S.C. § 13a-1.

[15] Section 6(b), 7 U.S.C. § 9.

[16] Section 14, 7 U.S.C. § 18.

detailed procedure was established, providing for the filing of customer complaints with the CFTC, and investigation of such claims by that body.[17] If the investigation supports further action, an administrative law judge is appointed to hear the claim. If a violation of the CEA is found, the CFTC, by statute, "shall" impose a damage award in favor of the aggrieved customer,[18] and such awards are enforceable in the federal district courts,[19] and reviewable in the courts of appeals.[20]

During the 44 years that section 4b has been in effect, and notwithstanding the extensive reconsideration and revision that Congress has afforded the CEA during that period (most notably in 1974), Congress has not seen fit expressly to authorize a private judicial right of action for violation of that section.

Several bills that would have expressly provided private judicial remedies for violations of the CEA were introduced in the 93d Congress but not enacted. One proposed amendment would have provided a right of action for restitution in the federal district courts for a

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[17] *Id.*

[18] Section 14(b), (c) and (e), 7 U.S.C. § 18(b), (c) and (e).

[19] Section 14(f), 7 U.S.C. § 18(f).

[20] Section 14(g), 7 U.S.C. § 18(g).

non-willful violation of "any provision of this Act or regulation or order issued thereunder," with a treble damage remedy for willful violations.[21] This proposal and several others like it were rejected by Congress.[22]

Further amendment to the CEA occurred in 1978, including the addition of a cause of action in favor of the States, acting as *parens patriae*, to enjoin violations of the Act, and original jurisdiction over such actions is expressly granted to the federal district courts.[23]

It is apparent that during consideration of the 1978 Amendments Congress was well aware that no private right of action was included within the regulatory scheme. A comprehensive list of public and private remedies provided *customers* under the CEA was set forth in the authoritative Senate Report. Mention of a private judicial remedy is conspicuous by its absence:

> The Commodity Exchange Act provides many customer protections and remedies. The Act directs the Commission to promulgate and administer a regulatory program that includes registration of commodity professionals, segregation of customers' funds by futures commission merchants, establishment of dual trading guidelines, creation of a procedure for the adjudication of reparation claims, monitoring

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[21] S. 2837 (Hart Bill), 93d Cong., 1st Sess., § 505(a)-(b), 119 *Cong. Rec.* 42688 (1973).

[22] *E.g.*, H.R. 11195 (Smith Bill), 93d Cong., 1st Sess. § 17 (1973) (treble damages); S. 2578 (McGovern Bill), 93d Cong., 1st Sess., Part I, § 20, 119 *Cong. Rec.* 33947-48 (1973) (treble damages).

[23] Section 6d, 7 U.S.C. § 13a-2.

> exchange arbitration procedures and disciplinary actions, and licensing of industry self-regulatory futures associations. Moreover, customers are afforded protection through the Commission's power to sue directly for injunctive relief and to invoke a full range of administrative remedies where appropriate to curb unlawful behavior.[24]

Aware that a private judicial damage remedy was not afforded customers under the CEA, Congress, as before, declined to authorize such a remedy.

The foregoing[25] reveals the methodical development over a 58 year period of a comprehensive scheme to regulate the commodities industry. Congress carefully identified the problems to be dealt with, balanced the interests of those involved in the market and enacted regulations and means of enforcement tailored to achieve its goals. In so doing, Congress defined the role to be played in the regulatory scheme by the federal courts. The district courts are given original jurisdiction in enforcement and injunctive actions by the CFTC,[26] and in injunctive actions by the States;[27] and are given

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[24] S. Rep. No. 95-850, 95th Cong., 2d Sess. 12-13, *reprinted in* [1978] *U.S. Code Cong. & Ad. News* 2087, 2100-01.

[25] The discussion of legislative history in this petition is necessarily abbreviated. A more complete analysis of that history, as it specifically relates to legislative intent concerning private remedies, is provided by the majority and dissenting opinions of Judges Friendly and Mansfield in *Leist* v. *Simplot*, Nos. 79-7402, 7464, 7482 (2d Cir., July 8, 1980). See also, pp. 19-23, *infra*.

[26] Sections 6b, 6c, 7 U.S.C. §§ 13a, 13a-1.

[27] Section 6d, 7 U.S.C. § 13a-2.

enforcement jurisdiction in reparation awards.[28] The courts of appeals are given statutory jurisdiction to review reparation awards and suspensions of trading privileges.[29]

The limited jurisdiction granted the federal courts is an essential element of the balance achieved by Congress in its regulatory scheme. By enactment of the provisions for resolution of disputes, sections 5a(11) and 14, 7 U.S.C. §§ 7a(11), 18, Congress chose not to impose upon registered persons such as Merrill Lynch the substantial expense and disruptive impact of federal litigation of private damage claims, *see Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 740-43 (1975), the burden of which would of necessity be passed on to the overall market in the form of higher commissions and diminished efficiency. Creation of a judicially inferred right of action would alter the balance inherent in the legislative scheme.

Implication of a private right of action would also impose an unnecessary burden upon the federal judicial system. The already massive and ever-increasing volume of commodities trading, often based upon verbal orders, gives rise to a significant number of customer-broker disputes. Congress expressly enacted the means by which such disputes are to be resolved, and specified only a limited role for the federal judiciary.[30] The majority below would scuttle this legislative plan, granting access to the federal courts for

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[28] Section 14(f), 7 U.S.C. § 18(f).

[29] Sections 6(b), 14(g), 7 U.S.C. §§ 9, 18(g).

[30] Section 14(f), 7 U.S.C. § 18(f) (enforcement of awards); section 14(g), 7 U.S.C. § 18(g) (appellate review).

adjudication of all cases alleging breaches of duties claimed to exist under section 4b. Such a burden on the federal courts is unnecessary since actions such as this one, alleging breach of fiduciary duty and fraud, not only are cognizable under section 14 reparation proceedings, but are a mainstay of state court litigation.

B. Implication of a private judicial right of action for fraud under the Commodity Exchange Act is an issue that has divided the lower federal courts.

Whereas prior to the CEA's substantial amendment in 1974, the few lower courts to treat the issue had generally recognized an implied private remedy under section 4b,[31] such harmony no longer exists. Creation in 1974 of the CFTC and the express provision for reparation proceedings to adjudicate customer complaints against registered persons, together with development of the restrictive approach to implication of private remedies manifest in this Court's recent decisions,[32] has left the lower federal courts sharply divided on the issue of whether an additional judicial remedy may be implied under section 4b.

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[31] *See, e.g., Goodman* v. *H. Hentz & Co.*, 265 F. Supp. 440 (N.D. Ill. 1967). Cf. *Deaktor* v. *L.D. Schreiber & Co.*, 479 F. 2d 529 (7th Cir.), *rev'd on other grounds sub nom. Chicago Mercantile Exchange* v. *Deaktor*, 414 U.S. 113 (1973).

[32] *National Railroad Passenger Corp.* v. *National Assn. of Railroad Passengers*, 414 U.S. 453 (1974); *Cort* v. *Ash*, 422 U.S. 66 (1975); *Securities Investor Protection Corp.* v. *Barbour*, 421 U.S. 412 (1975); *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975); *Piper* v. *Chris-Craft Industries*, 430 U.S. 1 (1977); *Chrysler Corp.* v. *Brown*, 441 U.S. 281 (1979); *Cannon* v. *University of Chicago*, 441 U.S. 677 (1979); *Touche Ross & Co.* v. *Redington*, 442 U.S. 560 (1979); *Transamerica Mortgage Advisors, Inc.* v. *Lewis*, 444 U.S. 11 (1979).

Several district court cases have reached the same result as the majority opinion below, implying a private right of action[33], while others support Judge Phillip's dissenting view that no implied private remedy exists.[34]

The divided panel below is the first court of appeals to address this issue. The Court of Appeals for the Second Circuit, in *Leist* v. *Simplot*, Nos. 79-7402, 7464, 7482 (July 8, 1980), also by a divided panel, recently reached a similar result, although *Leist* did not involve a section 4b claim by a customer against his own broker.

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[33] *Witzel* v. *Chartered Service Corp. of New York, Ltd.*, Civ. No. 4-79-610 (D. Minn, May 27, 1980); *Navigator Group Funds* v. *Shearson Hayden Stone, Inc.*, No. 77 Civ. 5350 (S.D.N.Y., March 20, 1980); *Smith* v. *Groover*, 468 F. Supp. 105 (N.D. Ill. 1979); *R. J. Herely & Son Co.* v. *Statler & Co.*, 466 F. Supp. 345 (N.D. Ill. 1979); *Jones* v. *B. C. Christopher & Co.*, 466 F. Supp. 213 (D. Kan. 1979); *Poplar Grove Planting & Refining Co.* v. *Bache Halsey Stuart Inc.*, 465 F. Supp. 585 (M.D. La. 1979); *Hofmayer* v. *Dean Witter & Co., Inc.*, 459 F. Supp. 733 (N.D. Cal. 1978); *Berenson* v. *Madda Trading Co.*, [1977-80] Comm. Fut. L. Rep. (CCH) paragraph, 20,689 (D.D.C. 1978); *Cf. Croll* v. *Maduff & Sons, Inc.*, No. CV 79-466-RMT (C.D. Cal., April 3, 1980); *Shearson Hayden Stone, Inc.* v. *Lumber Merchants, Inc.*, 423 F. Supp. 559 (S.D. Fla. 1976).

[34] *Mullis* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, No. 79-172 BRT (D. Nev., July 1, 1980); *Hensley* v. *Maduff & Sons, Inc.*, 2 Comm. Fut. L. Rep. (CCH) paragraph 21,017 (C.D. Cal. 1980); *Fischer* v. *Rosenthal & Co.*, 481 F. Supp. 53 (N.D. Tex. 1979); *National Super Spuds, Inc.* v. *New York Mercantile Exchange*, 470 F. Supp. 1256 (S.D.N.Y. 1979), *rev'd sub nom. Leist* v. *Simplot*, Nos. 79-7402, 7464, 7482 (2d Cir., July 8, 1980); *Berman* v. *Bache, Halsey, Stuart, Shields, Inc.*, 467 F. Supp. 311 (S.D. Ohio 1979) (overruled *sub silentio* by *Curran*); *Comstock Investors, Inc.* v. *Rosenthal & Co.*, [1977-80] Comm. Fut. L. Rep. (CCH) paragraph 20,934 (C.D. Cal. 1979); *Alkan* v. *Rosenthal & Co.*, [1977-80] Comm. Fut. L. Rep. (CCH) paragraph 20,797 (S.D. Ohio 1979) (overruled *sub silentio* by *Curran*); *Bartels* v. *International Commodities Corp.*, 435 F. Supp. 865 (D. Conn. 1979); *Consolo* v. *Hornblower & Weeks-Hemphill, Noyes, Inc.*, 436 F. Supp. 447 (N.D. Ohio 1976) (overruled *sub silentio* by *Curran*). *Cf. Stone* v. *Saxon & Windsor Group, Ltd.*, [1977-80] Comm. Fut. L. Rep. (CCH) paragraph 21,000 (N.D. Ill. 1980); *Liang* v. *Hunt*, [1977-80] Comm. Fut. L. Rep. (CCH) paragraph 20,880 (N.D. Ill. 1979).

In addition to the foregoing, there are undoubtedly many other federal court cases wherein the issue has not yet been decided or the decisions are not reported. Merrill Lynch is itself a party to several such pending cases.[35]

II. The Court of Appeals' implication of a private right of action for fraud under the Commodity Exchange Act conflicts in principle with the decisions of this Court in *Transamerica* and *Touche Ross*.

The majority opinion below implied a private judicial right of action under the CEA notwithstanding the absence of any persuasive evidence that Congress intended that such a right exist, and despite substantial evidence to the contrary. The majority's holding and the analysis by which it was reached are both in sharp conflict with guiding principles of statutory construction set forth by this Court in *Transamerica Mortgage Advisors, Inc* v. *Lewis*, 444 U.S. 11 (1979) and *Touche Ross & Co.* v. *Redington*, 442 U.S. 560 (1979). Rather than the sharp critical focus upon the narrow question of legislative intent, and the incisive search for "persuasive evidence" of intent that a private remedy exists, as required by *Touche Ross* and *Transamerica*, the majority below purported to follow the more diffuse analysis of *Cort* v. *Ash*, 422 U.S. 66 (1975), and in so doing, was drawn to render policy judgments beyond the scope of its proper judicial function.

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[35] *E.g., Dart Partnership* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, No. H80-1205 (D. Md.); *Para* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, No. 80-667 (W.D. Wash.); *Ames* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, No. 76 Civ. 3085 (S.D.N.Y.); *Wanty* v. *Merrill Lynch, Pierce, Fenner & Smith*, No. 77 Civ. 869 (RLC) (S.D.N.Y.); *Zeltser* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, No. 80 Civ. 4009 (S.D.N.Y.).

Cort set forth four criteria to guide the courts in deciding whether to imply a private cause of action[36]. The majority below applied these four factors and found that each supports implication of a private right of action for fraud under the CEA (A30-A34). The breadth of the four part *Cort* analysis has, however been sharply criticized, *Cannon* v. *University of Chicago*, 441 U.S. 677, 730-49 (1979) (Powell, J., dissenting) and its focus has since been sharpened by this Court:

> It is true that in *Cort* v. *Ash* . . . the Court set forth four factors that it considered 'relevant' in determining whether a private remedy is implicit in a statute not expressly providing one. But the Court did not decide that each of these factors is entitled to equal weight. *The central inquiry remains whether Congress intended to create, either expressly or by implication, a private cause of action.*

Touche Ross, supra, at 575 (emphasis added). The holdings of this Court subsequent to *Cort* also demonstrate the proper methodology of the "central inquiry" into Congressional intent.

The question whether a statute creates a cause of action, either expressly or by implication, is basically a matter of statutory construction, *Transamerica, supra*, at 15, and analysis must begin with the language of the statute itself. *Touche Ross, supra*, at 568. Further, "[a]bsent a *clearly expressed* legislative intention to the

[36] "First, is the plaintiff 'one of the class for whose *especial* benefit the statute was enacted' . . . that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? . . . Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? . . . And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law?" 422 U.S. at 78.

contrary" the language of a statute "must ordinarily be regarded as conclusive." *Consumer Product Safety Commission* v. *GTE Sylvania, Inc.*, — U.S. —, 48 U.S.L.W. 4658, 4659 (June 9, 1980) (emphasis added).

The language of the CEA contains no reference whatever to a private judicial right of action for violation of its anti-fraud provisions. Its language is, nonetheless, instructive: most significantly, the CEA provides a full panoply of criminal, civil and administrative remedies to enforce its regulatory function.

The majority below found this broad range of express enforcement measures to be evidence of Congressional intent to provide strong regulation of the commodities markets and then leapt, impermissibly, to the further conclusion that an *additional* remedy, a private right of action, is compatible with this goal and should therefore be judicially implied. This conclusion is at odds not only with the teachings of *Transamerica* and *Touche Ross*, but with the doctrine of the separation of powers.

The fact that a federal statute has been violated and some person harmed does not automatically give rise to a private cause of action in favor of that person. *Touche Ross, supra*, at 568. Instead, the judicial task is "limited solely to determining whether Congress intended to create the private right of action asserted." *Id.* Moreover, "it is an elemental canon of statutory construction that where a statute expressly provides a particular remedy or remedies, a court must be chary of reading others into it. 'When a statute limits a thing to be done in a particular mode, it includes the negative of any other mode.' " *Transamerica, supra*, at 19-20.

The CEA provides an express remedy for the type of violations asserted by the Currans. Section 14 provides for hearing before an administrative law judge and for damage awards enforceable and reviewable in the federal courts. These express provisions compel "the negative of any other mode," including an implied judicial remedy. They also render an implied remedy unnecessary and, as this Court held in *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 25-26 (1977), creation by judicial implication of a private damage remedy is proper only if it is *necessary* to effectuate Congress' goals. *See also, Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 734, 736 (1975).

The CEA's express provision for private damage awards arising out of statutory reparation proceedings further compels the conclusion that "[o]bviously . . . when Congress wished to provide a private damages remedy, it knew how to do so and did so expressly."[37] *Touche Ross, supra*, at 572. In addition, the full panoply of *express* provisions for enforcing duties imposed by the CEA and section 4b in particular make it "highly improbable that 'Congress absentmindedly forgot to mention an intended private action.' " *Transamerica, supra*, at 20 (quoting *Cannon, supra*, at 742 (Powell, J., dissenting)).

Transamerica contains the clear admonition that when a statute fails expressly to provide a private judicial right of action while providing for other express remedies, an additional right of action cannot be implied by the courts absent "persuasive evidence of a

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[37] *See also*, sections 308, 309, Packers and Stockyards Act, 7 U.S.C. §§ 209, 210 (providing agency reparation proceedings analogous to CEA section 14, while *expressly* providing an alternative judicial right of action).

contrary legislative intent." 444 U.S. at 20. The majority below failed to heed this admonition. No persuasive evidence of a congressional intent to provide a private judicial right of action for fraud exists. Indeed, the only support offered by the majority below for its holding that Congress intended an implied private remedy to exist is the fact that a few lower federal courts, using the discredited "tort theory" for implying a private right, had, previous to the 1974 Amendments, recognized such a right and that in the hundreds of pages of legislative history underlying the 1974 Amendments, one legislator had alluded to these decisions. This is not the "persuasive evidence" required by *Transamerica*, especially in light of the considerable evidence in the legislative history that no private judicial remedy was intended.

Moreover, the excerpts of legislative history offered by the majority in support of its holding are misconstrued. For example, the majority opinion states that "Congress recognized that the 'courts [had] implied a private remedy for individual litigants in the Commodity Exchange Act' " (A31, n. 27), citing the remarks of Representative Poage.[38] Representative Poage was, in fact, citing such private litigation as a threat to the self-regulatory activities of exchanges. Representative Poage expressed the view that private suits against exchanges for failure to enforce their rules offered exchanges "solid reason for shrinking the protection given the customer and the public through self-regulation".[39] In context, Representative Poage was citing private litigation as a discordant note in the

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[38] 119 *Cong. Rec.* 41333 (1973).

[39] *Id.*

regulatory scheme and as further reason for "Congress to act, and act expeditiously through meaningful, thoughtful change that is well reasoned and sure"[40] to provide the comprehensive, coherent and balanced regulatory scheme embodied in the 1974 Amendments.

Similarly misplaced is the majority's reliance (A31,n. 27) upon comments made during Senate hearings on the 1974 Amendments.[41] The testimony cited includes that of Professor Schotland, who argued emphatically for enactment of the private civil damage remedy contained in the Hart bill.[42] Professor Schotland also argued against the broad private reparation proceedings ultimately enacted as CEA section 14. The thrust of Professor Schotland's remarks was that adjudication of private damage claims should be in the courts and not in the CFTC. The Professor also argued that "[i]f you do choose to retain such virtually unprecedented responsibility and burden [section 14 reparation proceedings] in this regulatory body, there should be explicit language in the statute that Federal and State courts are still open if a complainant prefers to go to trial there."[43] As the 1974 Amendments make clear, Congress opted in favor of granting jurisdiction over

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[40] *Id.*

[41] *Hearings on* S. 2485, S. 2578, S. 2837 and H.R. 13113 *Before the Senate Comm. on Agriculture and Forestry*, 93d Cong., 2d Sess. pt. 1 at 205, pt. 3 at 737 (1974).

[42] S. 2837, 93d Cong., 1st Sess. § 505 (a), 119 *Cong. Rec.* 42688 (1973).

[43] *Hearings on* S. 2485, S. 2578, S. 2837 and H.R. 13113 *Before the Senate Comm. on Agriculture and Forestry*, 93d Cong., 2d Sess., pt. 3 at 737 (1974).

private damage claims to the CFTC under section 14 and against an alternative private remedy in the federal courts.

The majority below also places reliance (A31, n. 27) on the remark of Senator Clark that "section 201 of [H.R. 13113] may prohibit all court actions"[44] as evidence that the proviso to section 2(a)(1), 7 U.S.C. § 2, was added to preserve a private right of action for damages in the federal courts. The proviso states that "[n]othing in this section shall supersede or limit the jurisdiction conferred on courts of the United States or any State." The majority below, however, ignores the statements of Representative Rodino, Chairman of the House Committee on the Judiciary, who recommended that the proviso be added to avoid an interpretation that the jurisdictional provision eliminates the jurisdiction of state courts over contract claims and the jurisdiction of federal courts over anti-trust claims and suits seeking review of administrative hearings.[45]

The remark of Senator Clark, a passing reference by a single legislator, is a slim reed upon which to base a finding that Congress approved a private right of action. *Consumer Product Safety Commission* v. *GTE Sylvania, Inc., supra*, 48 U.S.L.W. at 4662; *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 31-32 (1977); *Chrysler Corp.* v. *Brown*, 441 U.S. 281, 311 (1979); *Leist* v. *Simplot, supra*, (Slip Op. at 4173) (Mansfield, J., dissenting). In view of the lengthy and authoritative

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[44] *Hearings on* S. 2485, S 2578, S. 2837 and H.R. 13113 *Before the Senate Comm. on Agriculture and Forestry*, 93d Cong., 2d Sess, pt. 1 at 205 (1974).

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[45] *Id.* at 259-260. *See also, Leist* v. *Simplot, supra* (Slip Op. at 4170-4174) (Mansfield, J., dissenting).

House and Senate Reports on the 1974 Amendments, both of which are silent as to the existence of any private judicial right of action, the remarks of Senator Clark and their bearing on the construction of section 2(a)(1) as the basis for a private judicial right of action are entitled to little weight.

The language of section 2(a)(1) itself contradicts the conclusion of the majority below. The proviso states only that the 1974 legislation was not passed in derogation of jurisdiction already "conferred" upon the courts. Prior to 1974, Congress had enacted no provision "conferring" jurisdiction on the courts to entertain private actions under the CEA. While a few federal courts had found an *implied* right of action under pre-1974 law, reliance on that factor is a bootstrap argument. The courts cannot "confer" jurisdiction upon themselves.[46] Thus, only if the pre-1974 federal commodity legislation had *expressly conferred jurisdiction* on the courts to entertain actions thereunder would section 2(a)(1) be of any value in explaining away Congress' conspicuous silence on that point when it completely overhauled the CEA in 1974. Since no pre-1974 provision existed, the implications of section 2(a)(1) (if any) are far outweighed by the straightforward legislative history discussed above, which is inconsistent with any intent to legislate a private right of action.

Further, in *Touche Ross, supra,* at 577, this Court declared that reliance upon the general jurisdictional provision of a statute in attempting to imply a private right of action is misplaced and that the source of a plaintiff's rights "must be found, if at all, in the

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[46] *U.S. Const.* art. III.

substantive provisions" of the act sought to be enforced. There is no substantive provision in the CEA for a private judicial right of action.

Finally, reliance by the majority below upon the remarks of Senator Talmadge (A28) is also misplaced The Senator's statement that under the statutory reparation proceedings "the entire *appeal* process and the right of *final* determination by the courts are expressly preserved" (emphasis added) plainly does not support the inference that original jurisdiction over private damage claims also exists.

It is apparent that the majority below, in implying a private judicial remedy, gave little weight to the plain language of the statute itself or to the great volume of legislative history, neither of which supports implication of such a right. The court below neither sought nor found "persuasive evidence" of Congressional intent that a private judicial remedy be implied. The majority below thus acted in direct contravention of the teachings of *Transamerica* and *Touche Ross*.

Perhaps the gravest error of the majority opinion, however, is its willingness to substitute its own judgment for that of Congress. The majority's inquiry under the third prong of the *Cort* analysis, and its finding that implication of a private right of action is "compatible" with the underlying purposes of the legislative scheme, do not justify reading the CEA more broadly than its language and the statutory scheme reasonably permit. *Touche Ross, supra,* at 578. "The ultimate question is one of Congressional intent, not one of whether [the Court] thinks that it can improve upon the statutory scheme that Congress enacted into law." *Id.*

In *Cannon, supra* at 718, Mr. Justice Rehnquist wrote that "[n]ot only is it 'far better' for Congress to so specify when it intends private litigants to have a cause of action, but for this very reason this Court in the future should be extremely reluctant to imply a cause of action absent such specificity on the part of the Legislative Branch." Sound justification for this "extreme reluctance," as set forth by the strong dissent of Mr. Justice Powell in *Cannon*, is based upon Article III of the United States Constitution and the doctrine of the separation of powers. As presaged by the opinions of Justices Rehnquist and Powell in *Cannon*, this Court, in *Touche Ross* and *Transamerica*, has held that a private right of action will be implied only when it is clear that Congress so intended. The effect of *Touche Ross* and *Transamerica* on the four part *Cort* analysis is to give primacy to legislative intent and subordinate the question of whether an implied remedy is "consistent with the underlying purposes of the legislative scheme" for the reason that,

> the *Cort* analysis too easily may be used to deflect inquiry away from the intent of Congress, and to permit a court instead to substitute its own views as to the desirability of private enforcement . . .
>
> . . . Determining whether a private action would be consistent with the 'underlying purposes' of a legislative scheme permits a court to decide for itself what the goals of a scheme should be, and how those goals should be advanced.

Cannon, supra at 740 (Powell, J. dissenting).

The inquiry of the majority below was thus "deflected" from its proper purpose, the determination

of Congressional intent. Its deflection, and its error, are apparent from its conclusion:

> What we have done here, in our view, is to preserve the general concept of a private right of action and to provide for its continuing development, not under the securities laws generally, but under those laws of Congress which are more particularly related to the commodities market. This approach provides greater sensitivity to the specialized concerns of that area of commercial life, appears consistent with congressional intent and also allows for the development of a private right of action similar to the valuable body of law that has grown under Section 10 of the Securities Exchange Act and Rule 10b-5. (A36).

The right to "*preserve* . . . a private right of action and to *provide* for its continuing development" is that of Congress alone. Had Congress preferred a private right of action and a "valuable body of law" analogous to that which has grown under the federal securities laws, Congress certainly knew how to so provide and would have done so expressly. *Touche Ross, supra,* at 572. Congress chose, however, *not* to do so and it is beyond the province of the Judicial Branch to amend the legislative scheme and thereby alter its balance.

Implication by the majority below of a private right of action for fraud under the CEA manifests an arrogation of the constitutional powers of the Legislative Branch and violates principles so recently emphasized by this Court in *Touche Ross* and *Transamerica*.

III. The Court of Appeals' retroactive application of Commodity Futures Trading Commission Reg. § 180.3 conflicts in principle with controlling decisions of this Court.

The Court of Appeals retroactively applied a 1976 regulation to void a 1973 agreement that provided for arbitration of a claim that had ripened in 1974. The Court of Appeals so acted despite the fact that the CFTC itself has interpreted the regulation as *not* voiding pre-existing agreements to arbitrate disputes that had arisen prior to the effective date of the regulation. *Ames* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 567 F.2d 1174, 1182 n.2 (2d Cir. 1977) (Meskill, J., dissenting) (quoting brief of CFTC, *amicus curiae*).

As pointed out by the cogent dissent of Judge Meskill in *Ames*, such a ruling violates no less than three canons of construction announced by this Court:

First, the CFTC's interpretation of its own regulation must be given "controlling weight unless it is plainly erroneous or inconsistent with the regulation." *Bowles* v. *Seminole Rock & Sand Co.*, 325 U.S. 410, 414 (1945). The Court below, relying on the *Ames* majority, gave no weight to the CFTC's interpretation.

Second, a new regulation should be interpreted in such a way as to avoid interference with matured

antecedent rights. *Greene* v. *United States*, 376 U.S. 149, 160 (1964); *Bradley* v. *Richmond School Board*, 416 U.S. 696, 720 (1974). Prior to the effective date of the regulation, Merrill Lynch had an accrued right to arbitrate this dispute. The interpretation of the regulation submitted by the CFTC as *amicus* in *Ames* avoided interference with this antecedent right.

Third, a regulation should be construed, whenever possible, so as to avoid constitutional issues. *See, Ashwander* v. *T.V.A.*, 297 U.S. 288, 348 (1936) (Brandeis, J., concurring). The interpretation of the Court below raises the substantial due process issue of whether the right to arbitration thus abrogated is substantive or procedural, and whether such abrogation results in "manifest unfairness." *Ames, supra*, at 1177, 1179.

CFTC Reg. § 180.3 should have been construed, as recommended by the CFTC in *Ames*, so as *not* to void arbitration agreements that pertained to disputes that existed as of the effective date of the regulation.

CONCLUSION

For the foregoing reasons this petition for a writ of certiorari should be granted.

Respectfully submitted,

Douglas G. Graham, counsel of record
Richard P. Saslow
Seymour M. Nayer
Butzel, Keidan, Simon, Myers & Graham
1990 First National Building
Detroit, Michigan 48226
Counsel for Petitioner,
Merrill Lynch, Pierce, Fenner & Smith, Inc.

Dated: August 5, 1980

QUESTIONS PRESENTED FOR REVIEW

I.

Does the Commodity Exchange Act create an implied private right of action for fraud in favor of a customer against his broker?

II.

Should Commodity Futures Trading Commission Reg. §180.3 be given retroactive application to void arbitration agreements entered into prior to the effective date of that regulation in abrogation of the parties' right to arbitration of a dispute that arose prior to that effective date?

APPENDIX

A-1

No. 77-1300

UNITED STATES COURT OF APPEALS

FOR THE SIXTH CIRCUIT

J. J. CURRAN and JACQUELYN L. CURRAN, individually and as trustees of the John J. Curran Living Trust and Jacquelyn L. Curran Living Trust,

Plaintiffs-Appellants,

v.

MERRILL LYNCH, PIERCE, FENNER AND SMITH, INC.,

Defendant-Appellee.

APPEAL from the United States District Court for the Eastern District of Michigan.

Decided and Filed May 12, 1980.

Before: LIVELY and ENGEL, Circuit Judges and PHILLIPS, Senior Circuit Judge.

ENGEL, Circuit Judge, delivered the opinion of the Court, in which LIVELY, Circuit Judge, joined. PHILLIPS, Senior Circuit Judge, (pp. 37-38) filed a separate opinion, concurring in part and dissenting in part.

ENGEL, Circuit Judge. Plaintiffs appeal from the district court's order granting partial summary judgment in favor of the defendant Merrill Lynch, Pierce, Fenner & Smith (hereinafter Merrill Lynch), and further granting Merrill Lynch's motion for stay of the remaining claims pending arbitration.[1]

[1] An order staying a pending action until the case is submitted to arbitration is appealable under 28 U.S.C. § 1292(a)(1) if the under-

In their complaint, plaintiffs John J. Curran and Jacquelyn L. Curran sought damages from Merrill Lynch for false representations made by its agents which induced plaintiffs to open discretionary commodity trading accounts with Merrill Lynch and for the broker's subsequent mismanagement of those accounts.

Specifically, plaintiffs allege that the accounts constitute investment contracts under federal law, and that Merrill Lynch violated Section 5 and Section 12(2) of the Securities Act by failing to file a registration statement before making an offer and sale of a security. Plaintiffs also assert that defendant made untrue statements of material fact, omitted to state material facts necessary to make the statements not misleading, and employed a device, scheme, or artifice which operated as a fraud upon plaintiffs, all in violation of Rule 10b-5, § 17 (a) of the Securities Act, § 6 of the Commodities Exchange Act, § 410(a)(2) of the Michigan Uniform Securities Act, and principles of common law. Plaintiffs further allege that defendant breached the commodity account agreement by: (1) failure to manage the accounts in a skillful and prudent manner; (2) failure to observe certain safeguards and stop-loss limits; and (3) failure to employ a scientific and comprehensive investment plan and instead, engaging in reckless and haphazard trading with the sole intention of generating large commissions.

The district court ruling presents several issues of first impression in this circuit. Initially, we must determine whether a discretionary trading account in commodity futures constitutes a "security" subject to the registration requirements and enforcement provisions of the federal securities laws. The court below determined the account was not a security and entered partial summary judgment against plaintiffs' se-

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lying action, as here, is legal in nature. *See Mansbach* v. *Prescott, Ball & Turben*, 598 F.2d 1017, 1022 (6th Cir. 1979); 9 Moore's Federal Practice ¶ 110.20[3].

curities claims, relying primarily on *Milnarik* v. *M-S Commodities, Inc.*, 457 F.2d 274 (7th Cir.), *cert. denied*, 409 U.S. 887 (1972). In *Milinarik* the Seventh Circuit, speaking through Mr. Justice Stevens (then Judge Stevens), held that a discretionary trading account in commodity futures is not a security because such accounts lack the "common enterprise" element required for an investment contract under *Securities Exchange Commission* v. *Howey*, 328 U.S. 293 (1946). We agree.

Further, we reject plaintiffs' contention that the account involved here, though not a security, should be treated as such because it was fraudulently misrepresented to include the essential elements of a common enterprise.

This appeal also presents substantial questions whether the district court should have stayed plaintiffs' other claims pending arbitration, and whether in all events the lawsuit is barred by a one-year limitation period provided for in the contract in question. Finally, for reasons set forth later, we have been obliged to consider, *sua sponte*, and have determined that an implied private right of action exists under the Commodity Exchange Act.[2]

I. FACTS

Plaintiffs, as customers of the broker-dealer defendant, Merrill Lynch, lost a substantial sum of money in the highly volatile and speculative futures market. These losses were allegedly sustained due to Merrill Lynch's mismanagement of plaintiffs' discretionary commodity accounts in a manner contrary to representations made when the contracts were made.

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[2] In *Kelley* v. *Carr*, —— F.2d —— (6th Cir. 1980) (decided March ——, 1980 File No. 78-1091/2), our court noted that the federal courts are in conflict over the continuing validity of a private implied right of action under the Commodity Exchange Act, following the 1974 amendments to the Act. The *Kelley* court, however, found it unnecessary to resolve the issue under the circumstances presented in that case. *Id.* at ——.

In 1973, plaintiffs opened several accounts for trading commodity futures in defendant's "Guided Commodities Account Program." In the written Customer Account Agreement, the parties agreed to submit any dispute under the contract to arbitration within one year after the accrual of such claim. As Merrill Lynch interprets the program, a customer deposits an amount he is prepared to risk in his own commodity trading account. Merrill Lynch further claims that although specific recommendations for purchase and sale are made by commodities specialists, the ultimate decision to act or not is made only upon the customer's direct order. However, plaintiffs have raised a question of fact with respect to that issue in the pleadings and Merrill Lynch has acknowledged that, for the purposes of this appeal only, the plaintiffs' commodity trading accounts must be deemed discretionary, with trading control in the hands of Merrill Lynch.

Plaintiffs allege that Merrill Lynch fradulently misrepresented how the account would be handled with respect to other accounts in the same program. They insist that the discretionary account was represented to involve several unique elements in that: (1) the program involved a specified number of investors who could not withdraw their capital for a minimum of 18 months; (2) the accounts were to be controlled by an individual trader who could direct buy/sell decisions on a broad basis and thereby control fluctuations in the market; (3) the capital availability and buying power generated by control over the group of accounts would create a multibuyer effect allowing the trader to buy as though he were buying five times greater the amount than if dealing with a separate account.

To support these contentions, plaintiffs state that after they opened the first account of $100,000 Merrill Lynch made all trading decisions and exercised complete control over plaintiffs' accounts. Initially, plaintiffs realized profits on the trading activity and at one point withdrew $101,007.80. Later, the

accounts declined in value and plaintiffs suffered excessive trading losses which they blame upon improper and excessive trading activities and a failure to observe the "stop loss" procedures represented to exist as part of the program. On several occasions, plaintiff John J. Curran requested that the accounts be closed and that plaintiffs be "cashed-out." On each occasion, except the final one (at which time plaintiffs' capital had been reduced to approximately $6,000), defendant either refused to follow his advice or convinced Curran that he was required to stay in the program for 18 months. In April, 1974, the defendants assented to plaintiffs' demands to "cash-out" the accounts. At that time plaintiffs assert that the accounts had declined in value approximately $175,000. Significantly, Merrill Lynch had in the meanwhile been paid $44,500 in commissions.

II.

A commodity future is a standardized contract for the purchase and sale of a fixed quantity of a commodity to be delivered in a specified future month at a price agreed upon when the contract is entered into. *See generally Bromberg, Securities Laws* § 4.6, at 82.181 (1975). Futures contracts are traded by futures commission merchants and floor brokers on national exchanges, or "contract markets," which are regulated by the Commodity Futures Trading Commission (CFTC).

Generally, a futures contract seller is characterized as being in a "short" position since he must deliver the commodity in accordance with the contract in order to receive the purchase price. The purchaser of a futures contract is labeled as holding a "long" position in that he must pay the contract price before receiving the commodity. Ordinarily, the number of trades far exceeds the number of actual deliveries since futures contracts are the subject of speculation by traders seeking to profit from their trading acumen, rather than from actually

delivering or receiving the commodity involved. As Judge Kinneary stated in *Berman* v. *Bache, Halsey, Stuart, Shields, Inc.*, 467 F. Supp. 311, 315-16 (S.D. Ohio 1979), "a commodities future contract is little more than a wager that the market price of a given commodity will change in a given direction by a specified future date." Normally, the trader's expectation of profit arises solely from speculative hope based upon his expertise in the market.

Although bare commodities are generally not considered securities, some courts have determined that an investment contract is formed when commodity accounts are managed by the seller or affiliate.[3] Typically, a customer trading in a discretionary commodity account gives the broker authority to buy and sell at the broker's discretion, without prior consultation with the customer. Discretionary accounts are more common for commodities where fast trading is required due to sharp movement in prices, a factor further magnified by the high leverage that results from generally low margin requirements.

While the underlying commodities themselves do not constitute securities, whether a discretionary commodity account constitutes an investment contract, and thus a security under the federal securities laws, is a current topic of dispute in the federal courts. The question is particularly difficult where there is no actual pooling of the customer's funds with those of other investors.

Whether a particular financial arrangement is considered an "investment contract,"[4] and therefore subject to the filing requirements of Section 5, Securities Act of 1933, and the

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[3] *See, e.g., Securities & Exchange Commission* v. *Continental Commodities Corp.*, 497 F.2d 516, 520 n.9 (5th Cir. 1971); *Glen-Arden Commodities, Inc.* v. *Constantino*, 493 F.2d 1027 (2d Cir. 1974); *Siuva, Inc.* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 253 F. Supp. 359 (S.D.N.Y. 1966).

[4] Section 2(1) of the Securities Act of 1933, 15 U.S.C. § 77(b)(1), and Section 3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C.

antifraud provisions of Section 10 and Rule 10b-5 of the Securities Exchange Act of 1934, is usually determined by measuring the arrangement against the requirements set forth in *Securities & Exchange Commission* v. *Howey, supra.* In *Howey,* the Supreme Court defined an investment contract as ". . . a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or third party. . . ." *Id.* at 298-99. It is universally recognized that the *Howey* test is comprised of three basic elements: (1) an investment of money, (2) in a common enterprise, with (3) profits to come solely from the efforts of others. Further, although the Supreme Court offered little guidance in defining these elements, it did note that the definition of a security,

> [E]mbodies a flexible rather than static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of money by others on the promise of profits.

Id. at 351. *See also United Housing Foundation, Inc.* v. *Forman,* 412 U.S. 837, 852 (1975).

The current debate usually focuses on whether a horizontal or a vertical relationship satisfies the "common enterprise" language of *Howey.* Plaintiffs assert that the common enterprise requirement is met by a vertical relationship, which

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78c(10) include the term "investment contract" in the definition of a security:

> The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificates for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. (Emphasis added.)

15 U.S.C. § 77b(1).

essentially is a one-on-one arrangement between the customer and broker. Horizontal relationships are those between an individual investor and the pool of other investors. In rendering summary judgment against plaintiffs' securities claims the district court applied the horizontal approach adopted in *Milnarik* v. *M-S Commodities, Inc., supra.*[5]

In *Milnarik*, Justice Stevens began his inquiry by observing that, in searching for the meaning and scope of the word "security," courts should disregard form in favor of substance and place the emphasis on economic reality. *Tcherepnin* v. *Knight*, 389 U.S. 332 (1967). He observed that not "every conceivable arrangement that would fit a dictionary definition of an investment contract was intended to be included within the statutory definition of a security." *Id.* at 375-76. Justice Stevens interpreted *Securities & Exchange Commission* v. *Howey, supra*, as stressing the significance of the common enterprise element in determining whether particular investment contracts are securities. The original complaint in *Milnarik* alleged a discretionary arrangement remarkably similar to the relationship here. The court noted, however, that "the success or failure of those other [customer's] contracts had no direct impact on the profitability of plaintiffs' contract. [The broker's] various customers were represented by a common agent, but they were not joint participants in the same investment enterprise." *Id.* at 276. The significance of this finding is found in *Milnarik's* adoption of the district court's further determination that:

> In essence, this contract creates an agency-for-hire rather than constituting the sale of a unit of a larger en-

[5] For cases adopting the horizontal commonality approach, *see also, Hirk* v. *Agri-Research Council, Inc.*, 561 F.2d 96 (7th Cir. 1977) (reaffirms *Milnarik*); *Wasnowic* v. *Chicago Board of Trade*, 352 F. Supp. 1066 (M.D. Pa. 1972), *aff'd without opinion*, 491 F.2d 752 (3rd Cir.), *cert. denied*, 416 U.S. 949 (1974); *Berman* v. *Bache, Halsey, Stuart, Shields Co.*, 467 F. Supp. 311 (S.D. Ohio 1979); *Arnold* v. *Bache & Co.*, 377 F. Supp. 61 (M.D. Pa. 1973); *Stuckey* v. *du Pont Glore Forgan, Inc.*, 59 F.R.D. 129, 131 (N.D. Cal. 1973).

> terprise. No matter how many different persons Nelson became an agent for under similar or even identical discretionary contracts, his relationship with each would remain as that of agent and principal. Each contract creating this relationship is unitary in nature and each will be a success or failure without regard to the others. Some may show a profit, some a loss, but they are independent of each other. No matter how many discretionary trading accounts Nelson may have had with other principals, the "security" "issued" to the plaintiffs, their discretionary trading account, could not be offered to anyone else. Although this Court recognizes that the registration requirements of Section 5 are for the protection of the public and that any exemption therefrom must be strictly construed against one claiming it, Securities and Exchange Commission v. Ralston Purine Co., [346 U.S. 119, 73 S.Ct. 981, 97 L.Ed. 1494]; Securities and Exchange Commission v. Culpepper, 270 F.2d 241 (2d Cir. 1959), the unitary nature of the contract here involved is not overcome even when the transaction is viewed most strongly against the defendants.

Id. at 277.

We reject plaintiffs' assertion that a pooling of investors' interests is not essential to a finding of common enterprise and hold that Justice Stevens' reasoning in *Milnarik* best comports with the language of *Howey* since the agreement entered into here was solely between plaintiffs as investors, and Merrill Lynch as broker, and it did not include a "common enterprise" element. Therefore, we conclude the district court had no jurisdiction under the federal securities laws and properly dismissed those claims for failure to state a cause of action.

By adopting *Milnarik*, we necessarily reject the vertical commonality approach primarily championed by the Fifth Circuit's decision in *Securities & Exchange Commission* v. *Continental Commodities Corp.*, 497 F.2d 516 (5th Cir. 1974).

In *Continental Commodities*, the district court followed the Seventh Circuit's reasoning in *Milnarik, supra*, primarily because each individual invested in different accounts and the investors had no expectation that they would share in a common fund comprised of the return on their investments.[6] The Fifth Circuit, however, refused to adopt the *Milnarik* approach and emphasized its view that a pro rata sharing of profits is not critical to a finding of commonality. Rather, the court preferred a resilient standard which would comport with the remedial purposes of the Securities Act of 1933 and the Securities Exchange Act of 1934. The court applied a test which the Ninth Circuit formulated to deal with the various pyramid-type investment schemes challenged in the courts as securities: a "common enterprise is one in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment or of third parties." *Securities & Exchange Commission* v. *Koscot Interplanetary, Inc.*, 497 F.2d 473 (5th Cir. 1974), *quoting Securities & Exchange Commission* v. *Glen W. Turner Enterprises*, 474 F.2d 476, 482 n. 7 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973).[7] Further, the court expressed the notion

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[6] It is interesting to note that the SEC had argued unsuccessfully before the district court in *Continental Commodities, supra*, that "trading in discretionary commodities accounts engaged in by Continental Commodities fell within the ambit of the term security, as defined by the Securities Act of 1933 and the Securities Exchange Act of 1934." 497 F.2d at 520.

[7] In *Brodt* v. *Bache & Co., Inc.*, 595 F.2d 459 (9th Cir. 1979), the Ninth Circuit recognized its prevailing definition of "common enterprise" as one in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment or of third persons. However, the court noted its inconsistency with *Milnarik*'s strict pooling requirement for discretionary commodity accounts. The *Brodt* court then distinguished a discretionary commodity account from its general test by stating:

> [I]n the instant case, the investor's return, while specifically determined by the commodities market, is also clearly affected by the expertise of the person doing the trading. . . . the success or failure of Bache as a brokerage house does not correlate with individual investor profit or loss. On the contrary, Bache could reap large commissions for itself and be characterized as suc-

that "the critical factor is not the similitude or coincidence of investor input, but rather the uniformity of impact of the promoter's efforts." 497 F.2d at 478.

In *Continental Commodities* the Fifth Circuit vigorously criticized Milnarik's elevation of the pooling ingredient to exalted status and held that "the critical inquiry is confined to whether the fortuity of the investments collectively is essentially dependent upon promoter expertise. . . . That it may bear more productive fruits in the case of some options than it does in others should not vitiate the essential fact that the success of the trading enterprise as a whole and customer investments individually is contingent upon the sagacious investment counselling of Continental Commodities." *Id.* at 522.[8] Although this approach has attracted some support,[9] we believe that no horizontal common enterprise can exist unless there also exists between discretionary account customers

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cessful, while the individual accounts could be wiped out. Here, strong efforts by Bache will not guarantee a return nor will Bache's success necessarily mean a corresponding success for Brodt. Weak efforts or failure by Bache will deprive Brodt of potential gains but will not necessarily mean that he will suffer serious losses. Thus, since there is no direct correlation on either the success or failure side, we hold that there is no common enterprise between Bache and Brodt.

Id. at 461. Specifically, *Brodt* concluded that "merely furnishing investment counsel to another for a commission, even when done by way of a discretionary commodities account, does not amount to a common enterprise." *Id.* at 462.

[8] *See also Merrill Lynch, Pierce, Fenner & Smith* v. *Goldman*, 593 F.2d 129 (8th Cir.), *cert. denied*, —— U.S. ——, 100 S.Ct. 76 (1979); *Moody* v. *Bache & Co.*, 570 F.2d 523 (5th Cir. 1978); *Booth* v. *Peavey Co. Commodities Services*, 430 F.2d 132 (8th Cir. 1970) (without explanation the court found a cause of action lies for churning a commodities account under the securities laws).

[9] *See Commercial Iron & Metal Co.* v. *Bache & Co.*, 478 F.2d 30 (10th Cir. 1973), *cert. denied*, —— U.S. ——, 99 S.Ct. 1229 (1979) (dictum); *Booth* v. *Peavey Co. Commodities Services*, 430 F.2d 132, 133 (8th Cir. 1970) (prior to *Milnarik*); *Marshall* v. *Lamson Bros. & Co.*, 368 F.Supp. 486 (S.D. Iowa 1974) (emphasis on "pooling" of funds in *Milnarik*-sense is too strict or literal limitation on definition of "investment contract"); *Johnson* v. *Arthur Espey, Shearson, Hammill & Co.*, 341 F. Supp. 764 (S.D.N.Y. 1972); *Berman* v. *Orimex Trading, Inc.*, 291 F. Supp. 701 (S.D.N.Y. 1968); *Mahen* v. *Reynolds & Co.*, 282 F. Supp. 423 (S.D.N.Y. 1968). *See also Consolo* v. *Hornblower &*

themselves some relationship which ties the fortunes of each investor to the success of the overall venture. Thus in our view the finding of a vertical common enterprise based solely on the relationship between promoter and investor is inconsistent with *Howey*.

Further support for *Milnarik's* rationale is found in *Berman* v. *Bache, Halsey, Stuart, Shields, Inc.*, 467 F. Supp. 311, 315-16 (S.D. Ohio 1979), where Judge Kinneary observed that:

> a finding of a common enterprise based solely upon the fact of entrustment by a single principal of money to an agent effectively excises the common enterprise requirement of *Howey*. The test would simply require (1) the investment of capital (2) with the expectation of profit through the efforts of others, for nothing more is involved in a single discretionary trading account. Although the precise meaning of the phrase "common enterprise" is far from clear, nowhere in *Howey* or later Supreme Court decisions is it intimated that that phrase is somehow redundant of other elements of the definition of a security.

Id. at 319.

III.

Even though we conclude that a discretionary commodity account is not a security, plaintiffs still claim the district court erred in dismissing the securities claims because while a "common enterprise" was not shown to exist, it was nonetheless fraudulently promised. In short, plaintiffs make the

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Weeks-Hemphill, Noyes, Inc., 436 F. Supp. 447 (N.D. Ohio 1976), where the court determined that a non-discretionary trading account in a commodities future was not an investment contract under the securities laws. However, in defining what is required to find an investment contract the *Consolo* court stated that a contract situation involving only two persons, i.e., the investor and his stock broker, does not admit of the common enterprise which is essential to the existence of an investment contract. *Id.* at 452.

interesting argument that the unfulfilled and fraudulent promise of a "common enterprise" with other Merrill Lynch customers itself brings the actual agreement made within the definition of a "security" and hence confers jurisdiction under the federal securities laws. Under such a circumstance, they urge it was improper for the district court to have entered summary judgment under Rule 56 because the deposition and affidavits submitted by the parties in connection with the motion for summary judgment raise a fact question of whether a "common enterprise" existed.[10]

We have earlier noted that the facts here are virtually identical to those in *Milnarik, supra*. One significant exception, however, is that the *Milnarik* court did not deal with the situation where the account is claimed to involve a pooling of funds, whereas in this case the plaintiffs allege that such misrepresentation occurred. The *Milnarik* court stated:

> This characteristic of common enterprise is completely lacking in the present case. Even assuming that Nelson in fact solicited and collected money from numerous parties, *no allegations are made that a common enterprise existed comprised of all people possessing discretionary account contracts with him. No claim is made that Nelson traded in a uniform manner for each of these accounts. Even if he had so uniformly traded, no pooling of funds for a common purpose is alleged.* Nelson was apparently simply an agent for a number of separate and distinct principals, the plaintiffs being one such principal. The plaintiffs in no way can be viewed as having invested in a common enterprise with other suppliers of venture capital.

Id. at 278. (emphasis added).

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[10] Upon summary judgment the inferences to be drawn from the underlying facts contained in supplemental materials must be viewed in a light most favorable to the party opposing the motion, *United States* v. *Diebold*, 369 U.S. 654, 655 (1962), and facts which are

The evidentiary matter before the district court included a deposition of Lawrence McMann, a Merrill Lynch customer account executive, and a counter affidavit of James Olin, Manager of a Detroit-area Merrill Lynch office. Olin stated that regardless of what plaintiffs may have been told, their account was handled independently of others involved in the program, and was never used in a manner that would suggest a common enterprise with the companion accounts. McMann testified, however, that although the account may have been handled as suggested by Olin, the Currans were given a different description of the account. Essentially, McMann stated that the account offered to the Currans was unique: the trader acted as controller of a group of accounts thus allowing him to make buy/sell decisions on a broader basis and thereby control fluctuations in the market. This control was represented as a trading capability five times greater than for a separate account.

We do not view this tempting expectancy as elevating the trading account to the full dignity of a security. Essentially it remained an agency for hire. It is true that plaintiffs may have hoped that defendant's control over a number of accounts would increase the agent's clout in the market. The fact remains, however, that the plaintiffs always understood that their return would be based on a one-to-one vertical relationship with the trader. They knew there was no contractual tie to other accounts.

IV.

Merrill Lynch asserted in the district court that plaintiffs' action was time-barred because the one year limitation period agreed upon in writing by the parties expired before the complaint was filed. The "Commodity Account Agreement"

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asserted, if supported by evidentiary material, must be accepted as true. *Day v. United Auto Aerospace Agric. Workers*, 466 F.2d 83 (6th Cir. 1972).

provided for submission of all disputes to arbitration within one year after the cause of action accrued.[11]

The accounts were opened April 5, 1973, and August 20, 1973. Plaintiffs claimed that they could not reasonably have known that defendant's representations were false until April, 1974. Judge Thornton, however, declined to rule on Merrill Lynch's claim that the action accrued more than one year prior to the April 5, 1976 filing of the complaint.

Merrill Lynch argues that absent a controlling statute to the contrary, a provision in a contract may validly limit the time for bringing an action for breach of contract to a period less than that prescribed in the general statute of limitations, at least if the shorter period is reasonable. *See, e.g., Order of United Commercial Travelers of America* v. *Wolfe*, 331 U.S. 586, 608 (1947).

Plaintiffs, however, assert that the one year limitation provision is tied to the arbitration clause in their discretionary trading account agreement, and that if arbitration is impermissible, the one year limitation also dies with it.[12] We agree.

V.

Plaintiffs assert that arbitration is not a favored remedy with respect to commodity futures brokerage transactions, citing statutory and administrative limitations upon the enforcement of an agreement to arbitrate. Specifically, Section

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[11] "Arbitration must be commenced within one year after the cause of action accrued by service upon the other of a written demand for arbitration or a written notice of intention to arbitrate, naming therein the arbitration tribunal."

[12] Plaintiffs' also assert that the Supreme Court in *Wilko* v. *Swan*, 346 U.S. 427 (1953), determined that an agreement to arbitrate cannot preclude an aggrieved purchaser of a "security" from seeking a judicial remedy under section 14 of the Securities Act of 1933. Further, the *Wilko* principle has been held equally applicable to claims under the Securities Exchange Act of 1934. However, due to our finding that the discretionary commodity account involved in this case is not a security, this argument is inapplicable.

5a of the Commodity Exchange Act, 7 U.S.C. § 7a(11), as amended by the Commodity Futures Trading Commission Act of 1974, P.L. 93463, 88 Stat. 1389, effective April 21, 1975, provides that each contract market is required to:

> (11) provide a fair and equitable procedure through arbitration or otherwise (such as by delegation to a registered futures association having rules providing for such procedures) for the settlement of customers' claims and grievances against any member or employee thereof; *Provided*, That (i) the use of such procedure by a customer shall be *voluntary*, (ii) the procedure shall *not be applicable to any claim in excess of* $15,000, (iii) the procedure shall not result in any compulsory payment except as agreed upon between the parties.

(Emphasis added).

In 1976, the CFTC adopted regulations under Section 7a (11) providing that no pre-dispute arbitration agreement may be enforced unless the agreement is contained in a separate document executed by the customer and contains adequate warnings in large print.[13] 17 C.F.R. § 180.1 *et seq.* (1976).

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[13] 17 C.F.R. § 180.3 states:

Voluntary procedure and compulsory payments.

(a) The use by customers of the dispute settlement procedures established by contract markets pursuant to the Act or this Part or of the arbitration or other dispute settlement procedures specified in an agreement under paragraph (b)(3) of this section shall be voluntary. The procedures so established shall prohibit any agreement or understanding pursuant to which customers of members of the contract market agree to submit claims or grievances for settlement under said procedures prior to the time when the claim or grievance arose, except in accordance with paragraph (b) of this section.

(b) No futures commission merchant, floor broker or associated person shall enter into any agreement or understanding with a customer in which the customer agrees, prior to the time the claim or grievance arises, to submit such claim or grievance to any settlement procedure except as follows:

(1) Signing the agreement must not be made a condition for the customer to utilize the services offered by the future commission merchant, floor broker or associated person;

Although the cause of action here arose before the effective date of the CFTC Act, plaintiffs argue that the Act's limitation upon arbitration should be retroactively applied. Plaintiffs urge that retroactive application is justified because the agreement here is an adhesion contract, forced upon plaintiffs and other like customers through unequal bargaining power and does not comply with the requirements of Section 180.3.

For its part, Merrill Lynch argues that the clause including the agreed limitation period is enforceable and that therefore the entire case should have been dismissed in the district

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(2) If the agreement is contained as a clause or clauses of a broader agreement, the customer must separately endorse the clause or clauses containing the cautionary language and other provisions specified in this section;

(3) The agreement may not require the customer to waive the right to seek reparations under section 14 of the Act and Part 12 of these regulations. Accordingly, the customer must be advised in writing that he or she may seek reparations under section 14 of the Act by an election made within 45 days after the futures commission merchant, floor broker or associated person notifies the customer that arbitration will be demanded under the agreement. This notice must be given at the time when the futures commission merchant, floor broker or associated person notifies the customer of an intention to arbitrate. The customer must also be advised that if he or she seeks reparations under section 14 of the Act and the Commission declines to institute reparation proceedings, the claim or grievance will be subject to the preexisting arbitration agreement and must also be advised that aspects of the claims or grievances that are not subject to the reparations procedure (i.e. do not constitute a violation of the Act or rules thereunder) may be required to be submitted to the arbitration or other dispute settlement procedure set forth in the preexisting arbitration agreement.

(4) The customer agreement must contain cautionary language, printed in large boldface type, to the following effect:

WHILE THE COMMODITY FUTURES TRADING COMMISSION (CFTC) RECOGNIZES THE BENEFITS OF SETTLING DISPUTES BY ARBITRATION, IT REQUIRES THAT YOUR CONSENT TO SUCH AN AGREEMENT BE VOLUNTARY. YOU NEED NOT SIGN THIS AGREEMENT TO OPEN AN ACCOUNT WITH [name]. See 17 CFR 180.1-180.6.

BY SIGNING THIS AGREEMENT, YOU MAY BE WAIVING YOUR RIGHT TO SUE IN A COURT OF LAW, BUT YOU ARE NOT WAIVING YOUR RIGHT TO ELECT AT A LATER DATE TO PROCEED PURSUANT TO SECTION 14 OF THE COM-

court. Merrill Lynch contends that neither in their briefs nor in their argument to the district court did plaintiffs argue that CFTC Regulation § 180.3, 17 C.F.R. § 180.3, could or should be applied retroactively. That regulation did not become effective until November 29, 1976, months after the case had been briefed and argued to the district court. Therefore, we are urged to disregard this argument because it is raised for the first time on appeal. *See Bannert* v. *American Can Co.*, 525 F.2d 104 (6th Cir.), *cert. denied*, 426 U.S. 942 (1975); *Schneider* v. *Electric Auto-Lite Co.*, 456 F.2d 366, 375 (6th Cir. 1972); *Cashner* v. *United States Steel Corp.*, 327 F.2d 533 (6th Cir. 1964) (court refused to consider issue not raised until a supplemental appellate brief was filed). The Supreme

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MODITY EXCHANGE ACT TO SEEK DAMAGES SUSTAINED AS A RESULT OF A VIOLATION OF THE ACT. IN THE EVENT A DISPUTE ARISES, YOU WILL BE NOTIFIED IF [name] INTENDS TO SUBMIT THE DISPUTE TO ARBITRATION. IF YOU BELIEVE A VIOLATION OF THE COMMODITY EXCHANGE ACT IS INVOLVED AND IF YOU PREFER TO REQUEST A SECTION 14 "REPARATIONS" PROCEEDING BEFORE THE CFTC, YOU WILL STILL HAVE 45 DAYS IN WHICH TO MAKE THAT ELECTION.

(5) If the agreement specifies a forum for settlement other than a procedure established pursuant to section 5a(11) of the Act or this Part, the procedures of such forum must comply with the requirements of § 180.5.

(c) The procedure established by a contract market pursuant to section 5a(11) of the Act or this Part may require parties utilizing such procedure to agree, under applicable state law, submission agreement or otherwise, to be bound by an award rendered in the procedure, provided that the agreement to submit the claim or grievance to the procedure was made in accordance with paragraph (b) of this section or that the agreement to submit the claim or grievance was made after the claim or grievance arose. Any award so rendered shall be enforceable in accordance with applicable law.

(d) The procedure established by a contract market pursuant to the Act or this Part shall not establish any unreasonably short limitation period foreclosing submission of customers' claim or grievances or counterclaims (permitted by § 180.4 or this Part) by contract market members or employees thereof.

(7 U.S.C. 7a(11), 12a (Supp. V, 1975))

[41 FR 42946, Sept. 29, 1976, as amended at 42 FR 3433, Jan. 18, 1977]

Court, however, in *Hormel* v. *Helvering*, 312 U.S. 552, 556 (1941), stated:

> There may always be exceptional cases or particular circumstances which will prompt a reviewing or appellate court, where injustice might otherwise result, to consider questions of law which were neither pressed nor passed upon by the court or administrative agency below.

In their supplemental brief, plaintiffs assert that *Ames* v. *Merrill Lynch, Pierce, Fenner & Smith*, 567 F.2d 1174 (2d Cir. 1977), supports the retroactive application of CFTC Reg. § 180.3 to bar arbitration here, and in so doing, also negates the one year limitation period written into it. In *Ames*, plaintiff signed the same standard form Merrill Lynch agreement as involved in this case. The plaintiff opposed a stay of arbitration on the ground that 17 C.F.R. § 180.3, which became effective on November 29, 1976, after the agreement was entered into, should be applied retroactively to render the arbitration agreement null and void. The Second Circuit agreed that the CFTC intended section 180.3 to be given retroactive effect and further observed that:

> A court must apply the law as it exists at the time of its decision, even where the law has changed during the pendency of the action, unless the statute or legislative history reveals an intention of prospective application only, or retroactive application would lead to "manifest injustice." *Bradley* v. *Richmond School Board*, 416 U.S. 696, 711, 94 S.Ct. 2006, 40 L.Ed.2d 476 (1974). In applying this principle to the instant case, we are called upon to determine: (1) whether the Commission had the authority to apply the provisions of § 180.3 to all arbitration agreements; (2) whether the Commission intended the application of the regulation to arbitration agreements antedating the regulation; and (3) whether, given the authority and intention to make the regulation effective as to antedated agreements, the particular circum-

> stance that the *dispute* arose before the effective date of the regulation nevertheless precludes its application.

Id. at 1177.

Before making its determination, the *Ames* court traced the evolution of Section 180.3. The Commodity Exchange Act, 7 U.S.C. § 7a(11), required only that each contract market provide a "fair and equitable procedure through arbitration or otherwise" for settlement of claims up to $15,000, and that the use of such procedure be voluntary on the part of the customer. Neither arbitration of claims over $15,000 nor arbitration outside the contract market were mentioned in the Act. The Commission, however, determined that arbitration outside the literal scope of the Act should be regulated, and under provisions in the Act giving the Commission authority "to make and promulgate such rules and regulations as are necessary to effectuate any of the provisions or to accomplish any of the purposes of the act," 7 U.S.C. § 12a(5), the Commission promulgated section 180.3.

Initial proposals submitted by the Commission sought to bar any agreement to arbitrate future disputes, but provided that grievances arising out of agreements actually entered into prior to the adoption of the regulations should be exempted. Later, the Commission decided that pre-dispute agreements would be tolerated, but only under conditions designed to insure that arbitration was truly voluntary. Also, the exemption for agreements antedating the regulation was withdrawn. As stated by the *Ames* court, "[i]nstead, the thrust was to include even pre-existing arbitration agreements in the new order of things." *Id.* at 1178. Therefore, in making the final regulation effective on November 29, 1976, the Commission announced that "on the effective date of proposed § 180.3(b), all pre-dispute arbitration agreements that do not satisfy the conditions set forth in the proposed rule will be null and void, including those heretofore signed by customers." 41 Fed. Reg. 42,944 (Sept. 29, 1976). The announcement made no mention

of the treatment to be accorded disputes already in existence. On this basis, the *Ames* court held that "§ 180.3 fairly read should apply to all arbitration agreements existing at the effective date of the regulation." *Id.* at 1179.[14] *See also Tamari* v. *Bache & Co. (Lebanon) S.A.L.*, 565 F.2d 1194 (7th Cir. 1977), *cert. denied*, 435 U.S. 905 (1978) (Swygert, J. dissenting); *Rothberg* v. *Loeb, Rhoades & Co.*, 445 F. Supp. 1336 (S.D.N.Y. 1978); *Milani* v. *Conticommodity Services, Inc.*, 462 F. Supp. 405, 406-07 (N.D. Cal. 1976).

The retroactive effect of an alteration in a regulatory scheme generally depends upon whether it affects litigation at a point which causes a result so unfair and inequitable that it is unconstitutional. Plaintiffs here sought equitable relief from the arbitration clause in their customer commodity account agreement at an early stage of the litigation, and no surprise or other unfairness is apparent upon the record. Under these circumstances we do not find that retroactive application of Regulation § 180.3 would result in manifest injustice.

Further, we note that the plaintiff in *Ames* appealed from a district court order compelling arbitration and staying trial of his action, and therefore, sought equitable relief from the effect of a similar arbitration agreement at the same stage of the proceedings as the plaintiffs in the instant case.[15] In support of its result, the *Ames* court stated:

> Shortly after its creation, in 1975, the Commission undertook an examination of the use of arbitration in the

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[14] Judge Meskill issued a vigorous dissent to the *Ames* majority, noting in part that the Commodity Futures Trading Commission, as amici, explained "that its intent to reach pre-existing agreements did not extend to cases where a dispute had already arisen at the time the regulation was adopted." 567 F.2d at 1181. Apparently Judge Meskill agreed with the basic portent of the regulation but thought that application to disputes already in existence was extremely unfair. He perceived no problems in allowing retroactive effect "to the extent necessary to bring about an immediate change in existing contracts without unnecessarily cutting off accrued rights." *Id.* at 1182-83.

[15] We note that in *Arkoosh* v. *Dean Witter & Co.* 571 F.2d 437 (8th Cir. 1978), plaintiff contended that section 180.3 rendered invalid

futures industry. It learned that arbitration was frequently conducted not under the auspices of the contract markets regulated by the Commission but through arbitration sponsored by the New York Stock Exchange or other securities-oriented organizations. It also became apparent that in many cases arbitration was not undertaken voluntarily by customers, but that customers were compelled to agree to pre-dispute arbitration clauses as a precondition to doing business. Indeed, this practice was found to be so prevalent that a customer might effectively be frozen out of the futures market if he refused to execute a predispute agreement. 41 Fed.Reg. 27,526 (July 2, 1976); 41 Fed.Reg. 42,945 (Sept. 29, 1976).

The Commission received written comments and took oral testimony on March 5, 1976. At this hearing conducted by the Commission, representatives both of Merrill Lynch and Shearson Hayden Stone conceded that a customer could not do futures business with the firm if he refused to sign a predispute arbitration agreement. Commodity Futures Trading Comm'n, *Oral Hearing on Arbitration and Other Dispute Settlement Procedures* 32-34, 37, 82-98. (March 5, 1976); see generally 41 Fed.Reg. 42,945 (Sept. 29, 1976).

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the arbitration clause in his customer agreement. The claim, however, was not made until after the district court had issued a stay of arbitration, and an arbitration award in defendant's favor had been granted. The *Arkoosh* court recognized the holding in *Ames* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 567 F.2d 1174, 1179 (2d Cir. 1977), and in fact concurred by stating: "[t]he regulation voided all existing pre-dispute arbitration agreements in contracts for the purchase of commodities unless certain conditions are met." *Id.* at 438. Further, the *Arkoosh* court recognized that generally "a court is to apply the law in effect at the time it renders its decision, unless doing so would result in manifest injustice . . . ." 571 F.2d at 438. (citations deleted). Within this context, the Eighth Circuit noted the district court's ruling that the chronological sequence demonstrated that plaintiff had ample time after the effective date of Section 180.3, and before the submission to arbitration, to urge the Court to reconsider its interpretation of the Customer Agreement. The defendant, having obtained the arbitration award, would suffer substantial injustice if the case was reopened, since plaintiff's assertion of his rights under the new regulation was untimely. Otherwise, the plaintiff could play it both ways, and seek relief to have arbitration set aside only if an unfavorable award is ordered.

Id. at 1178. In response to its fact-finding, the Commission, in announcing the effective date of the regulation, reiterated the nullity of all pre-dispute arbitration agreements not complying with the conditions of Section 180.3 but did not mention any exemption for existing disputes. 41 Fed. Reg. 42,942-44 (Sept. 29, 1976). As further noted in *Ames*, "any such exemption would hardly conform to the notion, stated by the Commission itself, that customers who had entered into agreements before adoption of the regulation needed and were entitled to the protections of the rule no less than those customers who signed agreements after November 29, 1976." *Id.* at 1177.

Our determination that Section 180.3 should be retroactively applied to invalidate the arbitration agreement in this case compels the further conclusion that the one year limitation period provided for therein is also inapplicable. The one year limitation was expressly contingent upon the institution of arbitration proceedings and the language of the agreement nowhere extends to any residual and underlying court action which may otherwise exist.

Accordingly, the order compelling arbitration and staying this action with respect to plaintiffs' commodity claims must be reversed and remanded to the district court.

VI.

Merrill Lynch has acknowledged that it did not consider the partial summary judgment in its favor, from which this appeal is taken, to have extended to or to have affected in any way the plaintiffs' claims under the Commodity Exchange Act (CEA).[16] Nevertheless, affirmance of the partial sum-

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[16] We construe the order of dismissal entered by the district court to grant only the relief requested by defendant's motion to dismiss, which related only to those allegations of the complaint purporting to state claims under the Securities Act of 1933 and the Securities Exchange Act of 1934. However, we view the pleadings and allegations in plaintiffs' complaint purporting to state a claim under the Com-

mary judgment and consequent remand to the district court for proceedings on the balance of the case necessarily raises the further question whether the federal district court has jurisdiction to entertain the remaining claims arising under the Commodity Exchange Act.[17]

Although the CEA does not expressly provide for a private right of action to recover damages, an implied right of action was generally thought to exist prior to the 1974 amendment of the Act.[18] Consistent with this view, no issue concerning the continuing validity of the implied right of action was raised in the court below, nor in this appeal.[19] Nevertheless,

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modities Exchange Act, 7 U.S.C. § 1, *et seq.*, as unimpaired by the district court's order of dismissal as, indeed, are the pendent state claims.

[17] In *Alexander* v. *Aero Lodge No. 735*, 565 F.2d 1364 (6th Cir. 1977), *cert. denied*, —— U.S. ——, 98 S.Ct. 2849 (1978), we recognized that a court of appeals should ordinarily limit its review of an interlocutory order to the narrow question of whether the district court abused its discretion and refrain from intruding into the merits of the case only to the extent necessary to decide that issue. We determined, however, that the rule is one of orderly judicial administration and not a limit on jurisdictional power. Therefore, it is generally recognized that a court possesses the jurisdictional power on the appeal of an interlocutory order under 28 U.S.C. § 1292(a)(1) to reach and decide other aspects of the order which would not be independently reviewable by interlocutory appeal. *Id.* at 1370. *See also Mansbach* v. *Prescott, Ball & Turben*, 598 F.2d 1017, 1022 (6th Cir. 1979) (interlocutory order staying a pending action submitted to arbitration is appealable under section 1292(a)(1) if the underlying action is legal in nature).

[18] *See, e.g., Deaktor* v. *L. D. Schreiber & Co.*, 479 F.2d 529 (7th Cir.), *rev'd on other grounds sub nom Chicago Mercantile Exchange* v. *Deaktor*, 414 U.S. 113, 94 S.Ct. 466, 38 L.Ed. 2d 344 (1973) (anti-manipulation provision of 7 U.S.C. § 13b); *Booth* v. *Pearcy Co. Commodity Services*, 430 F.2d 132 (8th Cir. 1970) (7 U.S.C. § 6b anti-fraud provision); *Goodman* v. *H. Hentz & Co.*, 265 F. Supp. 440 (N.D. Ill. 1967) (§ 6b); *United Egg Producers* v. *Bauer International Corp.*, 311 F. Supp. 1375 (S.D.N.Y. 1970) (§ 13b); *McCurnin* v. *Kohlmeyer & Co.*, 340 F. Supp. 1338 (E.D. La. 1972) (§ 6b); *Johnson* v. *Arthur Espey, Shearson, Hammill & Co.*, 341 F. Supp. 764 (S.D.N.Y. 1972) (§ 6b); *Arnold* v. *Bache & Co., Inc.*, 377 F. Supp. 61 (M.D. Penn. 1973) (§ 6b).

[19] Plaintiffs allege that this cause of action arose in 1974, prior to the amendment of the Commodity Exchange Act. At that time it was generally held that a private cause of action existed under the

to provide direction to the district court upon remand and to avoid further delay in this already protracted litigation, we review this issue and specifically agree that an implied private right of action survived the 1974 amendments to the Act.[20]

The original Commodity Exchange Act of 1936 established a scheme for regulating trading in agricultural commodities futures based primarily on the concept of self-regulation. The chief means of enforcement of the Act emanated from the Commission's regulations and the rules of each Exchange, to which the courts added an implied private right of action. The increasing effect of commodities trading on the nation's economy, and significant escalations in annual trading volume, also gave rise to increased instances of fraud and manipulation. By 1974, Congress became aware that the system of

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Act. *See* note 18, *supra*. In 1974 Congress amended the Commodity Exchange Act, 7 U.S.C. § 1, *et seq.*, effective in 1975, to create a comprehensive regulatory procedure for the processing of complaints within the newly-established Commodity Futures Trading Commission (CFTC). This action was filed on April 5, 1976. Since the amendment of the CEA the courts have adopted contrary views with regard to the continuing validity of the pre-1974 implied right of action. Although the parties have not raised this issue on appeal, it is well established that "a court is to apply the law in effect at the time it renders its decision, unless doing so would result in manifest injustice or there is statutory direction or legislative history to the contrary." *Bradley* v. *Richmond School Board*, 416 U.S. 696, 711 (1974). *See also Cort* v. *Ash*, 422 U.S. 66, 74 (1975); *Thorpe* v. *Housing Authority of the City of Durham*, 393 U.S. 268 (1969); *Bush* v. *State Industries Co.*, 599 F.2d 780 (6th Cir. 1979); *Weisenberger* v. *Huecker*, 593 F.2d 49 (6th Cir.), *cert. denied*, —— U.S. ——, 100 S.Ct. 170 (1979).

[20] In determining to proceed to the merits of this issue we recognize that in *Burks* v. *Lasker*, —— U.S. ——, 99 S.Ct. 1831, 1836 n. 5 (1979), the Supreme Court stated that "the question of whether a cause of action exists is not a question of jurisdiction, and therefore may be assumed without being decided." Under circumstances where petitioners never disputed the existence of a private right of action and the question had not been put to a test, the decision in *Burks* offers a tempting invitation to bypass the issue. That course, in fact, was taken by the court in *Chipser* v. *Kohlmeyer & Co.*, 600 F.2d 1061, 1067 & n. 14 (5th Cir. 1979) when faced with the precise issue in this case. In *Chipser*, however, plaintiff had filed his complaint prior to the amendment of the Act and the court determined that the implied right of action issue should be addressed in the first instance by the district court. For purposes of this appeal, however, we find the more expedient route is to apply the law in effect at the time of our decision and to reach the implied right of action issue.

self-regulation had decreased in effectiveness and sought to buttress the enforcement of the CEA safeguards.[21]

In 1974 Congress amended the Commodity Exchange Act to create the Commodity Futures Trading Commission and established an administrative procedure under which violations of any rule, provision, or regulation of the Act could be redressed by the commencement of an administrative proceeding before the CFTC to recover reparations.[22] 7 U.S.C. § 18 (e). Reparations procedures may be initiated against futures commission merchants, floor brokers, commodity trading advisers and commodity pool operators, but not against the contract markets (exchanges). A judgment rendered in a reparations proceeding remains subject to appeal in the courts of appeal and is enforceable in the district courts. Additionally, the 1974 amendments grant the CFTC plenary power over futures commission merchants and contract markets.[23] The

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[21] In *Smith* v. *Groover*, 468 F.Supp. 105 (N.D. Ill. 1979), the court noted that Congress traced the inadequacies of the self-regulatory scheme to a number of factors:

> First, the enforcement staffs of commodities exchanges were unable to handle the vastly increased trading volume. H.R. Rep. No. 975, 93d Cong., 2d Sess. 46 (1974). Also, exchanges faced "growing difficulties . . . as a result of private plaintiffs seeking damages against self-regulatory activities of the markets." *Id.* at 48. Because an implied right of action could be brought against an exchange for failure to enforce its own rules, "attorneys to several boards of trade had been advising the boards to *reduce*—not expand exchange regulations designed to insure fair dealing." *Id.* at 46. Finally, an exchange simply lacked the necessary motivation and vigilance to effectively police its own members.

Id. at 109-10.

[22] Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, 88 Stat. 1389 (codified at 7 U.S.C. § 1 *et seq.*). The Act was further amended in 1978. Futures Trading Act of 1978, Pub. L. No. 95-405, 92 Stat. 865 (codified at 7 U.S.C. § 1 *et seq.*).

[23] The CFTC may suspend or revoke the registration of a futures commission merchant or the designation of a contract market. 7 U.S.C. § 7b, 9. The CFTC is authorized to issue cease and desist orders against contract markets, 7 U.S.C. § 13a, and may assess civil penalties of up to $100,000 against futures commission merchants and contract markets. 7 U.S.C. § 9, 13a. Perhaps most significantly, the CFTC or the Attorney General at the CFTC's request, may bring an action in federal district court against futures commission mer-

creation of the CFTC was to provide a "strong Federal regulatory umbrella" to support the regulatory efforts of the exchanges in curbing unfair trading practices by providing public enforcement measures at both the exchange and individual level. H.R. Rep. No. 975, 93d Cong., 2d Sess. 48 (1974).

Although the 1974 amendments represented a thorough revision of congressional regulation over the commodities futures trading industry, the Act did not speak to the continuing validity of the pre-existing private right of action. We believe the legislative history of the CFTC Act, however, indicates that Congress intended to extend further protection to the exchange customer, rather than to extinguish existing forms of protection. This observation is bolstered by the fact that Congress recognized self-regulation as a "commendable and noble concept and useful in such a complex atmosphere as that which surrounds futures trading." H.R. Rep. No. 975, 93d Cong., 2d Sess. 48 (1974).

In addition to providing a more comprehensive regulatory scheme, it appears that Congress was motivated by a desire to clarify the jurisdictional dispute developing between the Commodity Exchange Commission and the Securities Exchange Commission with regard to commodities regulation under section 2 of the 1974 Act. Congress, therefore, vested exclusive jurisdiction over commodities futures trading with the CFTC. 7 U.S.C. § 4a. *See Smith* v. *Groover*, 468 F. Supp. 105 (N.D. Ill. 1979); *R. J. Herely & Son Co.* v. *Stotler & Co.*, 466 F. Supp. 345 (N.D. Ill. 1979); *Hofmayer* v. *Dean Witter & Co.*, 459 F. Supp. 733 (N.D. Cal. 1978). The exclusive jurisdiction provision, however, should not be construed as extinguishing the pre-existing private right of action by implication since the thrust of the provision was to ensure that regulatory bodies

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chants and contract markets for a restraining order, an injunction or a writ of mandamus to compel compliance with the Act or its regulations devised by the CFTC. 7 U.S.C. § 13a-1. Further, the 1978 amendments to the CEA added a provision whereby a state may bring an action under the CEA on behalf of its citizens. 7 U.S.C. § 13a-2.

other than the CFTC would not interfere with the orderly development and enforcement of commodities regulation. H.R. Rep. No. 93-975, 93 Cong., 2d Sess. 28 (1974). This result is further shown by additional language in the Act in which Congress provided that "nothing in this section shall supersede or limit the jurisdiction conferred on the courts of the United States or any State". 7 U.S.C. § 2. Further, it is apparent from the following statement that Congress intended to supplement existing remedies, rather than create a substitute for them:

> The vesting in the Commission of the authority to have administrative law judges and apply a broad spectrum of civil and criminal penalties is likewise *not intended to interfere with the courts in any way.* It is hoped that giving the Commission this authority will somewhat lighten the burden upon the courts, but the entire appeal process and the right of final determination by the courts are expressly preserved. (emphasis added).

Remarks of Senator Talmadge, 120 Cong. Rec. 30459 (1974).[24]

The CFTC has interpreted the Act as implicitly authorizing private actions, and asserts that the right must be presumed to have survived the 1974 amendments unless Congress explicitly abolished the private remedy in enacting the amendments. Statement of CFTC Concerning Referral of Private Litigation Under the Doctrine of Primary Jurisdiction. 41 Fed. Reg. 18471 (May 5, 1976). *See also Smith* v. *Groover*, 468 F. Supp. 105 (N.D. Ill. 1979) (amicus brief submitted by CFTC).

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[24] In 1978, Congress further amended the CEA, P.L. 95-405 (Oct. 1, 1978), 7 U.S.C. § 1, *et seq.*, to expressly allow the states, through Attorneys General or security regulations, to initiate actions in federal district court for CEA violations. This section does not indicate that Congress intended to extinguish private rights of action but rather, was meant to buttress the regulatory power of the CFTC, which is unable to regulate all aspects of commodities trading effectively. *See also Jones* v. *B.C. Christopher & Co.*, 466 F. Supp. 213 (D. Kan. 1979).

The judicial canon of construction which allows the court to grant considerable deference to the interpretation of a statute by an agency charged with its administration also supports the conclusion that the 1974 act did not preclude a private right of action. *See United States* v. *Consumer Life Ins. Co.*, 430 U.S. 725, 752 (1977); *NLRB* v. *Boeing Co.*, 412 U.S. 67, 75 (1973). However, the Supreme Court indicated in *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 41, n. 27 (1976), that the administrative deference rule is not applicable where the narrow legal issue is whether a cause of action should be implied in favor of a particular class of litigants by judicial interpretation. *See also National Super Spuds, Inc.* v. *New York Mercantile Exchange*, 470 F. Supp. 1256 (S.D.N.Y. 1979).

We admit that a recognized private right of action need not be re-examined every time the statutory scheme from which it is implied is altered. Nevertheless case law since the 1974 amendments has raised at least some uncertainty as to the continued vitality of the implied right, especially when analyzed in light of *Cort* v. *Ash*, 422 U.S. 66 (1975).[25] *See also Smith* v. *Groover*, 468 F. Supp. 105, 112 (N.D. Ill. 1979).

The Supreme Court established a four-part test in *Cort* to determine whether Congress intended a private remedy to be implied from legislation which created enforceable rights but remained silent as to the form of remedy. Since the 1974

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[25] In response to these developments the courts have either: (1) presumed the continuing validity of the private remedy without taking into account *Cort* v. *Ash*, 422 U.S. 66 (1975), or the 1974 amendments. *See Ames* v. *Merrill Lynch, Pierce, Fenner & Smith*, 567 F.2d 1174, 1176 (2d Cir. 1977); *Case & Co.* v. *Board of Trade of City of Chicago*, 523 F.2d 355 (7th Cir. 1975); *Kelley* v. *Carr*, 442 F. Supp. 346 (W.D. Mi. 1977) *rev'd on other grounds*, —— F.2d —— (6th Cir. 1980); *E. F. Hutton & Co.* v. *Lewis*, 410 F. Supp. 416 (E.D. Mi. 1976); (2) determined that the 1974 amendments were intended to serve as a supplemental rather than a substitutionary remedy, and therefore permit plaintiffs to bring a direct cause of action in federal court without attempting to exhaust the administrative reparations remedy provided by Congress. *See, e.g., Smith* v. *Groover*, 468 F. Supp. 105 (N.D. Ill. 1979); *Jones* v. *B.C. Christopher & Co.*, 466 F. Supp. 213 (D. Kan. 1979); *R. J. Hereby & Son Co.* v. *Stotler & Co.*, 466 F. Supp. 345 (N.D. Ill. 1979); (3) held that while the 1974 amend-

amendments, the implied right of action inquiry has centered primarily on the issues of Congress' legislative intent in enacting the 1974 amendments and the consistency of the statutory scheme with the Commodity Exchange Act.

In *Cort* v. *Ash, supra,* the Court delineated four relevant factors to determine whether a private right of action may be implied under a federal statute:

> First, is the plaintiff "one of the class for whose *especial* benefit the statute was enacted," . . . that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? . . . Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? . . . And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law?

Id. at 78. *See also Transamerica Mortgage Advisors, Inc.* v. *Lewis,* — U.S. —, 48 U.S.L.W. 4001, 4002 (November 13, 1979); *Touche Ross & Co.* v. *Redington,* — U.S. —, 99 S. Ct. 2479 (1979); *Cannon* v. *University of Chicago,* 441 U.S. 677 (1979); *Piper* v. *Chris-Craft Industries,* 430 U.S. 1, 37 (1976).

The first element is easily satisfied. Clearly investors in the commodities markets are within the class "for whose especial benefit the statute was enacted." The legislative history of

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ments did not extinguish the implied right of action previously recognized, a plaintiff must first exhaust his administrative remedies. *See Bartels* v. *International Commodities Corp.,* 435 F. Supp. 865 (D. Conn. 1977); *Consolo* v. *Hornblower & Weeks-Hemphill, Noyes, Inc.,* 436 F. Supp. 417 (N.D. Ohio 1976), or; (4) determined that the combination of the 1974 amendments and the decision in *Cort* v. *Ash, supra,* extinguished the private cause of action since the CEA as amended did not meet the four-part test of *Cort. See Berman* v. *Bache, Halsey, Stuart, Shields, Inc.,* 467 F. Supp. 311 (S.D. Ohio 1979); *National Super Spuds, Inc.* v. *New York Mercantile Exchange,* 470 F. Supp. 1256 (S.D.N.Y. 1979); *Fischer* v. *Rosenthal & Co.,* 481 F. Supp. 53 (N.D. Tex. 1979).

the 1974 amendments shows that the primary purpose was to protect against manipulation of markets and to protect individuals who desire to participate in futures market trading.[26] 7 U.S.C. § 6b. *See, e.g., Smith* v. *Groover*, 468 F. Supp. 105 (N.D. Ill. 1979); *Berman* v. *Bache, Halsey, Stuart, Shields, Inc.*, 467 F. Supp. 311, 322 (S.D. Ohio 1979); *National Super Spuds, Inc.* v. *New York Mercantile Exchange*, 470 F. Supp. 1256 (S.D.N.Y. 1979). *But see Liang* v. *Hunt*, 477 F. Supp. 891 (N.D. Ill. 1979) (distinguished claims involving excessive speculation and price manipulation in violation of statutory limits from fraud actions).

The second factor, whether there is any explicit or implicit indication of legislative intent to grant or deny a private right of action, also supports the implication of a private action under the CEA. The legislative history of the 1974 amendments indicates that Congress was aware of the fact that the federal courts had implied the existence of a private right of action under the CEA.[27] Further, the "exclusive jurisdiction"

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[26] See 120 Cong. Rec. Senate 30466 (1974) (remarks of Sen. Dole); 120 Cong. Rec. Senate 34998-99 (1974) (remarks of Sen. Clark). *See also Ames* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 567 F.2d 1174, 1179 (2d Cir. 1977).

[27] Congress recognized that the "courts [had] implied a private remedy for individual litigants in the Commodity Exchange Act." Remarks of Rep. Poage, 119 Cong. Rec. 41333 (1973). In fact, the Senate Committee on Agriculture and Forestry inserted a proviso into the exclusive jurisdiction section, 2(a)(1), that, "[n]othing in this section shall supersede or limit the jurisdiction conferred on courts of the United States or any State." The proviso resulted from testimony warning that the cumulative effect of the reparation provision and the exclusive jurisdiction section might be interpreted as repealing the jurisdiction of the courts to hear private damage actions. Hearings on S. 2485, S. 2578, S. 2938 and H.R. 13113 Before the Senate Committee on Agriculture and Forestry, 93d Cong., 2d Sess. pt. 1 at 205, pt. 3 at 737 (1974). *See also Smith* v. *Groover*, 468 F. Supp. 105, 114 (N.D. Ill. 1979).

Further, it is a rule of statutory construction that Congress is presumed to have been aware of existing constructions of statutes and does not intend to overrule them if the provision is re-enacted in substantially the same form. *Alabama Ass'n. of Ins. Agents* v. *Board of Governors of the Federal Reserve System*, 533 F.2d 224 (5th Cir. 1976); *Hofmayer* v. *Dean Witter & Co.*, 459 F. Supp. 733 (N.D. Cal. 1976).

provision of the CFTC, 7 U.S.C. § 2 (amended),[28] does not indicate an intention to abolish the pre-1974 implied right of action, as previously noted, particularly since Congress included in Section 2(a)(1) that "nothing in this section shall supersede or limit the jurisdiction conferred on the courts of the United States or any State." The Conference Committee which adopted the language offered by the Senate explained in its report that the purpose of the amendment was "to make clear that nothing in the Act would supersede or limit the jurisdiction presently conferred on courts of the United States or any State." 120 Cong. Rec. 34997 (October 10, 1974); 120 Cong. Rec. 34737 (October 9, 1974). Therefore, we believe that the reparations procedure established in the 1974 amendments, as construed by the relevant legislative history shows that Congress intended the administrative remedy to serve "as a supplement to, rather than a substitute for, the existing private right of action." *Smith* v. *Groover, supra,* 468 F. Supp. at 113-14. *But see National Super Spuds, supra,* 470 F. Supp. at 1260; *Berman, supra,* 467 F. Supp. at 322.[29]

The third element of *Cort*, whether the implication of a private right of action would be consistent with the underlying

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[28] 7 U.S.C. § 2 states, in part:

> That except as hereinabove provided, nothing contained in this section shall (i) supersede or limit the jurisdiction at any time conferred on the Securities and Exchange Commission or other regulatory authorities under the laws of the United States or of any State, or (ii) restrict the Securities and Exchange Commission and such other authorities from carrying out their duties and responsibilities in accordance with such laws. Nothing in this section shall supersede or limit the jurisdiction conferred on courts of the United States or any State.

[29] *National Super Spuds, Inc.* v. *New York Mercantile Exchange*, 470 F. Supp. 1256 (S.D.N.Y. 1979), and *Berman* v. *Bache, Halsey, Stuart, Shields, Inc.*, 467 F. Supp. 311, 322 (S.D. Ohio 1979), also held that the establishment of an extensive administrative reparations process and the plenary grant of disciplinary and regulatory power to the Commodity Futures Trading Commission evidenced a congressional intent to deny a private right of action under the Act, through application of the maxim "expressio unius est exclusio alterius"; the expression of one thing is the exclusion of another.

purposes of the Act is also met in this case. As stated in *Smith* v. *Groover*:

> [T]he continued existence of a private right of action for aggrieved investors is perfectly compatible with the language and purpose of the CFTCA. Affording injured commodities futures buyers a multiplicity of remedies against futures traders will deter the sort of manipulative pricing practices alleged to have been committed by defendants. As shown above, Congress intended the reparations proceedings in the CFTC to constitute an alternative to the more time-consuming, cumbersome, expensive and formal adjudication of private claims in federal or state courts. The availability of a variety of remedies thus harmonizes well with the Congressional intent to protect the public from fraud and price manipulation.
>
> Recent administrative interpretations of the CFTCA also demonstrate the compatibility of a private right of action with the purposes of the Act. The CFTC has consistently interpreted the reparations section as permitting commodity customers an election of forums in which to pursue their claims. *See* 41 Fed.Reg. 3994 (1976); 41 Fed.Reg. 18472 at n.5 (1976); *Stucki* v. *American Options Corp.*, CCH Comm.Fut.L. Rep. ¶ 20,559 at 22,283 (CFTC 1978). The CFTC will not even entertain a reparation claim if civil court litigation involving the same facts and parties has been instituted. 17 C.F.R. § 12.21(a)(7) (1977). We recognize that "... the consistent construction of a statute 'by the agency charged with its enforcement is entitled to great deference by the courts.'" *United States* v. *Consumer Life Insurance Co.*, 430 U.S. 725, 752, 97 S.Ct. 1440, 1454, 52 L.Ed.2d 4 (1977), quoting from *NLRB* v. *Boeing Co.*, 412 U.S. 67, 75, 93 S.Ct. 1952, 36 L.Ed.2d 752 (1973); *see also, Chemehuevi Tribe of Indians* v. *Federal Power Commission*, 420 U.S. 395, 409-10, 95 S.Ct. 1066, 43 L.Ed.2d 279 (1975).

468 F. Supp. at 115. *But see National Super Spuds, supra*, 470 F. Supp. at 1260; *Berman, supra*, 467 F. Supp. at 322-23.

The fourth factor, whether the implication of a private right would infringe on an area of state concern is not crucial here since *Cort* v. *Ash, supra,* at 84-85, indicates that a court should imply a private remedy when relegation to state law would frustrate the purpose of the federal statute. This factor favors the implication of a private right of action since the regulation of commodity futures trading is essentially a matter of federal concern.

Our analysis of the effect of the 1974 amendments to the Commodity Exchange Act, within the framework of *Cort* v. *Ash,* persuades us that the amendments did not impair the validity of the pre-existing implied private right of action. Rather, Congress appears to have armed aggrieved investors with a supplementary remedy in creating the reparations procedures to be followed under CFTC authority.

Finally our research persuades us that the primary jurisdiction doctrine should not be invoked here to compel exhaustion of the administrative reparations procedures before instituting a private action.[30]

The primary jurisdiction doctrine is intended to ensure that private suits will not interfere with the orderly development of precedent or exercise of discretion by an agency. The principal reason for invoking the doctrine in an action arising under the CEA would be to avoid interfering with the CFTC's administration of the regulatory scheme. The

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[30] The primary jurisdiction doctrine is a rule of judicial construction which permits a court, in exercise of its sound discretion, to defer to an administrative agency for the initial resolution of certain disputes. This doctrine is usually invoked when resolution of a dispute will require special skill or knowledge peculiar to a certain agency. *See United States* v. *Western Pac. R. Co.*, 352 U.S. 59 (1956); *Jones, supra,* at 222; *Hofmayer, supra,* at 738; *Shearson Hayden Stone, Inc.* v. *Lumber Merchants, Inc.*, 423 F. Supp. 559 (S.D. Fla. 1976). The courts have generally refused to apply the doctrine to fraud claims under the Commodity Exchange Act. *See, e.g., Smith* v. *Groover*, 468 F. Supp. 105 (N.D. Ill. 1979); *Hofmayer* v. *Dean Witter & Co.*, 459 F. Supp. 733 (N.D. Cal. 1978). *But See Bartels* v. *International Commodities Corp.*, 435 F. Supp. 865 (D. Conn. 1977); *Consolo* v. *Hornblower & Weeks-Hemphill, Noyes, Inc.*, 436 F. Supp. 447 (N.D. Ohio 1976).

preservation of an implied right of action does not, of course, interfere with the rulemaking power conferred upon the CFTC by Congress or with the opportunity of the Commission to apply its expertise through that power to complement the orderly development of precedent and procedure.

In determining whether to invoke the primary jurisdiction doctrine the courts must balance the need for special expertise and the extent to which administrative relief is available. *Eluska* v. *Andrus*, 587 F.2d 996, 999 (9th Cir. 1978). In a case where the primary issues involve allegations of fraud rather than a complex manipulative scheme, the special expertise of the CFTC is not a prerequisite to a just resolution. The facts here are far different from those which prompted reversal and remand in *Chicago Mercantile Exchange* v. *Deaktor*, 414 U.S. 113 (1973). There the district court of appeals had refused a stay of an action against the Chicago Mercantile Exchange charging antitrust and Commodity Exchange Act violations through manipulation of the futures market in fresh eggs. The stay was requested to afford the Commodity Exchange Commission an opportunity to determine whether the conduct under scrutiny violated the CEA or its own rules. The Supreme Court in *Deaktor* observed, as it had in *Ricci* v. *Chicago Mercantile Exchange*, 409 U.S. 289 (1973), that the trial court "should avail itself of the abilities of the Commission to unravel the intricate and technical facts of the commodity industry and to arrive at some judgment as to whether the Exchange had conducted itself in compliance with the law." *Id.* at 115. It therefore observed that claims "should be routed in the first instance to the agency whose administrative functions appear to encompass adjudication of the kind of substantive claims made against the [defendant]." *Id.* at 115. *See also Jones* v. *B. C. Christopher & Co.*, 466 F. Supp. 213 (D. Kan. 1979). No such intricate and technical facts are involved here. On the contrary, the CFTC has itself noted that the application of primary jurisdiction is "rarely, if ever" appropriate for

claims within "private litigation seeking damages for alleged violations of provisions of the Act," and that "[t]he issues raised by a particular fraudulent scheme, however complicated, are entirely within the conventional ability of the courts." Fed. Reg. Doc. 76-12906 (May 3, 1976). *See also Jones, supra*, at 222-23; *Shearson Hayden Stone, Inc.* v. *Lumber Merchants, Inc.*, 423 F. Supp. 559 (S.D. Fla. 1976).

CONCLUSION

Judge Phillips' dissent accurately calls attention to a number of Supreme Court decisions which, we agree, indicate a tendency to be more restrictive in implying a private right of action. While we recognize potential merit in this view, especially in light of the comprehensive administrative scheme embodied in the 1974 amendments, we are not persuaded that Congress intended to extinguish the pre-existing private right of action which had been generally acknowledged to exist under the Act. *See* note 18, *supra*. What we have done here, in our view, is to preserve the general concept of a private right of action and to provide for its continuing development, not under the securities laws generally, but under those laws of Congress which are more particularly related to the commodities market. This approach provides greater sensitivity to the specialized concerns of that area of commercial life, appears consistent with congressional intent and also allows for the development of a private right of action similar to the valuable body of law that has grown under Section 10 of the Securities Exchange Act and Rule 10b-5. It is arguable, of course, that some particular actions or claims may require initial submission to the Commodity Futures Trading Commission under the primary jurisdiction doctrine. Suffice it to say, however, that such problems do not exist here and can be properly addressed as they arise, on a case-by-case basis.

Accordingly, the partial summary judgment entered by the district court denying plaintiffs' relief on their claims under

federal securities law is affirmed. However, that part of the order which stays plaintiffs' fraud claims under the Commodity Exchange Act is reversed and remanded to the district court for proceedings consistent with this opinion.

PHILLIPS, Senior Circuit Judge. (Concurring in part and dissenting in part.) I respectfully dissent from the holding of the majority that an implied private right of action exists under the Commodity Exchange Act. With this exception, I concur in the majority opinion.

My dissent on the implied right of action issue is based on the failure of Congress, when it amended the Act in 1974, to specify that it intended to continue to allow private damage actions despite its creation of an elaborate administrative reparations procedure. *See Transamerica Mortgage Advisors, Inc.* v. *Lewis*, —— U.S. ——, 48 U.S.L.W. 4001 (Nov. 13, 1979) (Congress' express provision of alternative means to enforce § 206 of the Investment Advisors Act of 1940 precludes implication of a private damage remedy thereunder); *Securities Investor Protection Corp.* v. *Barbour*, 421 U.S. 412 (1975) (Securities Investor Protection Act's assignment to the SEC of "plenary authority" to supervise the SIPC precludes customers of failing broker-dealers from maintaining private suits to compel SIPC to act for their benefit); *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers*, 414 U.S. 453 (1974) (§ 307(a) of the Rail Passenger Service Act of 1970, which allows the Attorney General to file suits to force railroads to comply with the Act, negates any private cause of action to enforce compliance). *Cf. Touche Ross & Co.* v. *Redington*, 442 U.S. 560 (1979) (no implied private damage remedy under § 17 (a) of the Securities Exchange Act of 1934); *Taylor* v. *Brighton Corp.*, —— F.2d —— (6th Cir. Feb. 14, 1980) (no implied private damage remedy under § 11(c) of OSHA); *Ryan* v. *Ohio Edison Co.*, 611 F.2d 1170 (6th Cir. 1979) (no

implied private right of action under the Bankruptcy Act to prevent creditors from using informal methods to collect discharged debts).

Justice Rehnquist, concurring in the decision of *Cannon* v. *University of Chicago*, 441 U.S. 677, 718 (1979), stated what I believe to be the guiding principle:

> Not only is it "far better" for Congress to so specify when it intends private litigants to have a cause of action, but for this very reason this Court in the future should be extremely reluctant to imply a cause of action absent such specificity on the part of the Legislative Branch.

I would hold the plaintiffs have no implied private right of action under the amended Commodity Exchange Act. *See Fischer* v. *Rosenthal & Co.*, 481 F. Supp. 53 (N.D. Tex. 1979).

MEMORANDUM RE MOTION TO DISMISS AND STAY PROCEEDINGS

United States District Court
Eastern District of Michigan
Southern Division
(Filed Dec. 27, 1976)
Civ. No. 6-70683

J. J. Curran, et al., Plaintiffs, vs. Merrill Lynch, Pierce, Fenner and Smith, a Delaware Corp., Defendant.

In their Complaint herein plaintiffs allege that the amount in controversy is in excess of $10,000 and that jurisdiction is conferred on this Court by Section 27 of the Securities Exchange Act of 1934, by Section 22(a) of the Securities Act of 1933, by 28 U.S.C. § § 1331, 1332 and 1337 and by pendent jurisdiction. They also allege that the acts complained of occurred within this judicial district.

The Court has here for consideration defendant's Motion To Dismiss Or, In The Alternative, To Dismiss In Part And Stay Proceedings Pending Arbitration. This motion was argued before the Court and the parties have submitted substantial and thorough briefs. Since plaintiffs have submitted the deposition of one Lawrence McMann and defendants have submitted the affidavit of one James Olin, with supporting exhibits, the motion herein will be treated as one for summary judgment. Rule 12(b), F.R.Civ.P.

Plaintiffs, in their Reply Memorandum In Opposition To Motion To Dismiss And Stay Proceedings, filed August 25, 1976, set forth certain matters contained in the Complaint which are here recited for purposes of indicating the background against which this litigation is set:

During the year 1973, Plaintiffs opened several accounts with the Defendant brokerage firm, at least two of which were for the purpose of trading in commodity futures. The accounts were opened after numerous representations were made concerning Defendant's trading acumen and the profits which would inure to Plaintiffs as participants in Defendant's "Specialized Guided Account Trading Program" (hereinafter referred to as the "Program").

It is further alleged that as a condition to participation in the Program, which was then being offered by Defendant to persons across the country through telephone and face-to-face solicitations, Plaintiffs had to agree to all of the terms and conditions established by Defendant in connection with the Program. Among other things, Plaintiffs agreed to participate in the Program for at least eighteen (18) months and to follow all of the Defendant's trading "suggestions." Other aspects of the Program, as represented to Plaintiffs, were periodic reviews by the local Speculative Sales Department manager and specific stop loss procedures designed to limit the amount of capital which could be lost by Plaintiffs.

After the Program accounts were opened by Plaintiffs, Defendant made all trading decisions and exercised complete control over Plaintiff's accounts with complete reliance by Plaintiffs upon Defendants' actions and decisions. Contrary to the unsupported allegations set forth in Defendant's memorandum, Plaintiffs "never initiated or suggested any trade made by Defendant in said commodity accounts." (Complaint, paragraph 17). Accordingly, the

accounts were "discretionary accounts" as that term is defined and understood in the brokerage community and in numerous judicial decisions.

Plaintiffs' Complaint further sets forth that Defendant, in breach of the agreement between the parties and of the fiduciary duties owed to Plaintiffs, committed fraudulent, reckless and negligent acts motivated solely by self-interest in connection with Plaintiffs' accounts, resulting in significant financial damage to the Plaintiffs.

Analyzing the relationship between Plaintiffs and Defendant as described in the Complaint and in the deposition of Lawrence McMann, an employee of Defendant during the period at issue, it is readily apparent that the accounts maintained by Plaintiffs were not typical commodity trading accounts or even typical discretionary commodity accounts. By virtue of their participation in the Program, Plaintiffs had specialized commodity accounts quite unlike any ordinary account. For example, Plaintiffs, who were greatly concerned about their mounting losses, requested on several occasions that they be "cashed out" of their positions. In an ordinary account, their wishes would be promptly fullfilled but in the instant case *Defendant refused to follow Plaintiffs' instructions* because Plaintiffs had not remained in the Program for eighteen (18) months and "such action was not in accordance" with the Program (Complaint, paragraph 28). Furthermore, in an ordinary commodity account, the funds invested by the customer are segregated and utilized solely in connection with trades executed for his

account. In the course of his deposition, Mr. McMann testified that all funds received by Defendant from participants in the Program were transmitted to Defendants' New York office where these *funds were pooled and used by Defendant to engage in futures trading with the Program participants sharing pro rata in the contracts which were purchased or sold.* This pooling of interest or "common enterprise" aspect of the Program is another indication that these were no ordinary commodity accounts but rather constituted an opportunity for a unique form of deception.

In its Motion to Dismiss defendant moves:

> 1. That this action be dismissed pursuant to Rule 12(b)(6) Fed.R.Civ.P., for the reason that the limitation period agreed upon in writing by the parties expired prior to filing of the Complaint, or
>
> 2. That, in the alternative, the Court dismiss pursuant to Rule 12(b)(6) Fed.R.Civ.P., those allegations of the Complaint purporting to state claims under the Securities Act of 1933 and the Securities Exchange Act of 1934, to wit: Counts IV, V and VI of the Complaint, and
>
> 3. Stay proceedings of the remaining claims pending arbitration, pursuant to the written agreement of the parties and the Federal Arbitration Act, 9 U.S.C. § 3.

As to the first ground for its Motion to Dismiss, defendant's position is that the Commodity Accounts Agreements entered into between plaintiffs and defendant provided that all disputes be submitted to

arbitration and that such arbitration must be commenced within one year after the accrual of the cause of action. Defendant contends that the claims alleged by plaintiffs in their Complaint filed April 5, 1976 accrued more than one year prior to its being filed, and that the instant action is, therefore, time-barred. The accounts which are the subject of this lawsuit were opened with defendant on or about April 5, 1973 and August 20, 1973. According to the allegations in plaintiffs' Complaint plaintiffs discovered the alleged "false, fraudulent and deceitful nature of the representations as set forth herein and at that time, in April 1974, plaintiffs insisted the accounts be cashed out" (Compl. p. 9). Plaintiffs allege that they "did not know nor have any reasonable basis to know that the said representations were false, but believed and relied upon said representations as being true" (Compl. p. 9), until sometime in April 1974. On the basis of said allegations the Court will not at this posture of these proceedings determine that plaintiffs' action is time-barred.

As to the second ground of defendant's Motion to Dismiss, the defendant seeks dismissal of Counts IV, V and VI because they purport to state claims under the Securities Act of 1933 and the Securities Exchange Act of 1934, when in fact the contracts involved are not securities within the meaning of the Acts. The issue for determination here is whether or not plaintiffs' agreements/transactions with defendant involve securities. The purchase and sale of commodity futures contracts are the subject of the dealings between the parties. The term "security" as used in the Act is defined as follows:

> The term "security" means any note, stock, treasury stock, bond, debenture, evidence of

> indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorgainzation certificate or subscription, transferrable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. 15 U.S.C. § 77b(1).

The operative term in the above definition is "investment contract." If plaintiffs' agreements or accounts with defendant were investment contracts then a "security" situation existed and was subject to the two Acts and plaintiffs' cause of action is properly founded jurisdictionally on them, as to Counts IV, V and VI. Less simple is the determination of an investment contract. The parties hereto are in agreement and our research indicates that the Sixth Circuit has not had occasion to speak to this issue. Two Courts of Appeals have. They have reached opposite conclusions, both courts relying on the guidelines laid down by the Supreme Court in *S.E.C.* v. *Howey Co.*, 328 U.S. 293 (1946). The *Howey* case involved investments by customers in citrus acreage in Lake County, Florida. Customers were offered a land sales contract and a service contract. They received warranty deeds upon full payment on the purchase price. The service contract gave Howey-in-the-Hills Service, Inc. a leasehold interest and complete possession of the acreage. The service company was in charge of the

cultivation of the groves and of the harvesting and marketing of the crops. An allocation of the net profits was made based on a check made at the time of picking. With respect to this operation the requirements of the Securities Act of 1933 were not complied with. If the transaction involved was an investment contract, hence a security, then defendants were guilty of failing to comply with the statutory and administrative rules in making the offerings. The Court in *Howey* stated, at page 297:

> The legal issue in this case turns upon a determination of whether, under the circumstances, the land sales contract, the warranty deed and the service contract together constitute an "investment contract" within the meaning of § 2(1).

The Court further went on to say, at pages 298-299:

> By including an investment contract within the scope of § 2(1) of the Securities Act, Congress was using a term the meaning of which had been crystallized by this prior judicial interpretation. It is therefore reasonable to attach that meaning to the term as used by Congress, especially since such a definition is consistent with the statutory aims. In other words, an investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise. Such

> a definition necessarily underlies this Court's decision in S.E.C. v. *Joiner Corp.*, 320 U.S. 344, and has been enunciated and applied many times by lower federal courts. It permits the fulfillment of the statutory purpose of compelling full and fair disclosure relative to the issuance of "the many types of instruments that in our commercial world fall within the ordinary concept of a security." H.Rep.No. 85, 73d Cong., 1st Sess., p. 11. It embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.

This tripartite test has been applied by those courts considering the question of whether an investment contract has been made by an investor. As to tests one and three, we think they must be deemed to be met in the circumstances of the transactions here. Plaintiffs invested large sums of money with defendant for the purpose of gaining the benefit of its expertise in the commodity trading market. They signed agreements giving defendant the power and authority to buy and sell for them. The parties are in disagreement as to whether plaintiffs did or did not have the right to direct/approve the transactions made by defendant in their accounts. Plaintiffs contend they had no say in the matter, while defendant says they did. Regardless of the resolution of such dispute we deem it undeterminative of the investment contract question. We think there can be little question that plaintiffs invested their money and were led to expect profits solely from the efforts of defendant.

The troublesome test of the tripartite guidelines is the second one, namely, that of a common enterprise. In

Securities and Exchange Commission v. *Continental Commodities Corp.*, 497 F.2d 516 (5th Cir. 1974) the Fifth Circuit dealt with this in a case which also involved commodity futures. The district court had held that the element of common enterprise was absent and that, therefore, no investment contract existed. "[T]he district court deemed the requisite commonality absent for two reasons: first, because each individual invested in different options, the accounts of individual investors were unrelated; and second, there was no understanding or expectation that investors would share in a common fund comprised of the returns on their investments. These reasons constituted the very impediments to a finding of commonality in Milnarik."* *Continental, supra*, p. 521. The Court of Appeals (in *Continental*) then goes on to comment on the holding of the Seventh Circuit in *Milnarik* which had declined to find a common enterprise in a discretionary commodity futures account. The Fifth Circuit, in *Continental*, stated that it could not "accept" the *Milnarik* view and reversed the determination of the district court. The Court, in *Continental*, seems to take the view that the element of common enterprise as such is less important than the other elements and that if the tests of "investment of money" and "led to expect profits solely from the efforts of others" are met, the common enterprise element somehow is blanketed in. The Court, in *Continental*, points out that "the success of the trading enterprise as a whole and customer investments individually, is contingent upon the sagacious investment counseling of Continental commodities. This conclusion comports with the resilient approach

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* *Milnarik* v. *M-S Commodities*, 457 F.2d 274 (7th Cir. 1972).

this court adopted to the 'solely from the effects of others' element in SEC v. Koscot Interplanetary, Inc. and the similar approach to the common enterprise element which that decision presaged.'"* *Continental, supra*, pages 522-523.

Our reading of *Howey* leaves us with the distinct impression that the Court there laid down a test comprising three elements. The Court in that relatively short opinion reiterated this test and these elements a number of times, the last of which was in the final paragraph of the opinion where the Court stated:

> The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others.

In a previous paragraph the Court referred to a "profit-seeking business venture" in which the "investors provide the capital and share in the earnings and profits; the promoters manage, control and operate the enterprise." *Howey, supra*, page 300. When the Seventh [*sic*] Circuit in *Continental* uses the term "resilient approach" it apparently does so in reliance on the language in *Howey* where the Court, in reference to its definition of investment contract (one that relies on the three elements hereinabove set forth), says that it "embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits" (*Howey, supra*, page 299). We view this as a characterization of

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* SEC v. Koscot Interplanetary, Inc., 497 F.2d 473 (5th Cir. 1974).

the definition set down by the Court and not as license to interpolate or relax the necessary ingredients.

Plaintiffs in the instant case made an investment in defendant broker's Guided Commodity Account Program, giving defendant authority to trade in commodities futures for plaintiffs' account(s). Plaintiffs at first realized profits from the trading that was done on their behalf by defendant. Subsequently losses were suffered by plaintiffs. Defendant's financial interest in the transactions was limited to commissions. We are unable to perceive how this sort of arrangement can be held to involve a common enterprise, regardless of how many other customers' accounts were being handled by defendant under similar arrangements.

We conclude that defendant's motion to dismiss Counts IV, V and VI of the Complaint for failure to state claims under the Securities Act of 1933 and the Securities Exchange Act of 1934 should be granted for the reason that no security was involved here since there was no "investment contract" as that term has been construed by the Supreme Court in the *Howey* case.

In light of the determination hereinabove made, we conclude that the third ground of defendant's motion is sound. If a security were involved herein the arbitration provision contained in the agreement between the parties would not be enforceable. Defendant, in its Reply Memorandum at page 12, concedes this. Since, however, we conclude that the parties hereto were not dealing in securities the arbitration agreement is not subject to the non-enforceability provision of the federal securities acts and is, therefore, valid.

An order may be presented in accordance with the foregoing.

By: /s/ Thomas P. Thornton
United States District Judge

Dated: 12-27-1976

ORDER

United States District Court
Eastern District of Michigan
Southern Division
(Filed, Feb. 23, 1977)
Civ. No. 6-70683

J. J. Curran, et al., Plaintiffs, vs. Merrill Lynch, Pierce, Fenner and Smith, a Delaware Corp., Defendant.

At a session of said Court held in the Federal Building, Detroit, on February 23, 1977. Present, Honorable Thomas P. Thornton, United States District Judge.

The motion of Defendant to Dismiss or, in the alternative, to dismiss in part and stay proceedings pending arbitration, having come on for hearing, the briefs of the parties with respect thereto having been filed and considered, the Court being fully advised in the premises, and the Court having rendered its Memorandum Opinion with respect thereto dated December 27, 1976,

IT IS HEREBY ORDERED that Counts IV, V and VI of Plaintiff's Complaint be and the same hereby are dismissed, and

IT IS FURTHER ORDERED that further proceedings in this Court are hereby stayed pending completion of proceedings in accordance with the arbitration agreement between the parties.

/s/ Thomas P. Thornton
United States District Judge

JUDGMENT

United States Court of Appeals
For the Sixth Circuit
(Filed May 12, 1980)
No. 77-1300

J. J. Curran, et al., Plaintiffs-Appellants, vs. Merrill Lynch, Pierce, Fenner and Smith, a Delaware Corp., Defendant-Appellee.

Before Livley and Engel, Circuit Judges and Phillips, Senior Circuit Judge.

APPEAL from the United States District Court for the Eastern District of Michigan.

THIS CAUSE came on to be heard on the record from the United States District Court for the Eastern District of Michigan and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be and the same is hereby affirmed in part, reversed in part, and remanded for further proceedings.

Each party to pay own costs on appeal.

ENTERED BY ORDER OF THE COURT

/s/ John P. Hehman
clerk

Issued as Mandate: June 9, 1980

Commodity Exchange Act

Section 2(a)(1), 7 U.S.C. §2

Definitions

For the purposes of this chapter "contract of sale" shall be held to include sales, agreements of sale, and agreements to sell. The word "person" shall be construed to import the plural or singular, and shall include individuals, associations, partnerships, corporations, and trusts. The word "commodity" shall mean wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, Solanum tuberosum (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil and all other fats and oils), cottonseed meal, cottenseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice, and all other goods and articles, except onions as provided in section 13—1 of this title, and a.l services, rights, and interests in which contracts for future delivery are presently or in the future dealt in: *Provided*, That the Commission shall have exclusive jurisdiction with respect to accounts, agreements (including any transaction which is of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or "decline guaranty"), and transactions involving contracts of sale of a commodity for future delivery, traded or executed on a contract market designated pursuant to section 7 of this title or any other board of trade, exchange, or market, and transactions subject to regulation by the Commission pursuant to section 23 of this title: *And provided further*, That, except as hereinabove provided, nothing contained in this section shall (i) supersede or limit the jurisdiction at any time conferred on the Securities and Exchange Commission or other regulatory authorities under the laws of the United States or of any State, or (ii) restrict the Securities and Exchange Commission and such other authorities from carrying out their duties and responsibilities in accordance with such laws. Nothing in this section shall supersede or limit the jurisdiction conferred on courts of the United States or any State. Nothing in this chapter shall be deemed to govern or in any way be applicable to transactions in foreign currency, security warrants, security rights, resales of installment loan contracts, repurchase options, government securities, or mortgages and mortgage purchase commitments, unless such transactions involve the sale thereof for future delivery conducted on a board of trade. The term "future delivery" as used in this chapter, shall not include any sale of any cash commodity for deferred shipment or delivery. The words "board of trade" shall be held to include and mean any exchange or association, whether incorporated or unincorporated, of persons who shall be engaged in the business of buying or selling commodity or receiving the same for sale on consignment. The words "interstate commerce" shall be construed to mean commerce between any State, Territory, or possession, or the District of Columbia, and any place outside thereof; or between points within the same State, Territory, or possession, or the District of Columbia, but through any place outside thereof, or within any Territory or possession, or the District of Columbia. The words "cooperative association of pro-

ducers" shall mean any cooperative association, corporate or otherwise, not less than 75 per centum in good faith owned or controlled, directly or indirectly, by producers of agricultural products and otherwise complying with sections 291 and 292 of this title, including any organization acting for a group of such associations and owned or controlled by such associations, provided that business done for or with the United States of America, or any agency thereof, shall not be considered either member or non-member business in determining the compliance of any such association with said section. The words "member of a contract market" shall mean and include individuals, associations, partnerships, corporations, and trusts owning or holding membership in, or admitted to membership representation on, a contract market or given members' trading privileges thereon. The words "futures commission merchant" shall mean and include individuals, associations, partnerships, corporations, and trusts engaged in soliciting or in accepting orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market and that, in or in connection with such solicitation or acceptance of orders, accepts any money, securities, or property (or extends credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom. The words "floor broker" shall mean any person who, in or surrounding any "pit", "ring", "post", or other place provided by a contract market for the meeting of persons similarly engaged, shall purchase or sell for any other person any commodity for future delivery on or subject to the rules of any contract market. The words "the Commission" shall mean the Commodity Futures Trading Commission established under section 4a of this title. The term "commodity trading advisor" shall mean any person who, for compensation or profit, engages in the business of advising others, either directly or through publications or writings, as to the value of commodities or as to the advisability of trading in any commodity for future delivery on or subject to the rules of any contract market, or who for compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning commodities; but does not include (i) any bank or trust company, (ii) any newspaper reporter, newspaper columnist, newspaper editor, lawyer, accountant, or teacher, (iii) any floor broker or futures commission merchant, (iv) the publisher of any bona fide newspaper, news magazine, or business or financial publication of general and regular circulation including their employees, (v) any contract market, and (vi) such other persons not within the intent of this definition as the Commission may specify by rule, regulation, or order: *Provided*, That the furnishing of such services by the foregoing persons is solely incidental to the conduct of their business or profession. The term "commodity pool operator" shall mean any person engaged in a business which is of the nature of an investment trust, syndicate, or similar form of enterprise, and who, in connection therewith, solicits, accepts, or receives from others, funds, securities, or property, either directly or through capital contributions, the sale of stock or other forms of securities, or otherwise, for the purpose of trading in any commodity for future delivery on or subject to the rules of any contract mar-

ket, but does not include such persons not within the intent of this definition as the Commission may specify by rule or regulation or by order.

Sept. 21, 1922, c. 369, § 2(a)(1), formerly § 2(a), 42 Stat. 998; June 15, 1936, c. 545, §§ 2, 3, 49 Stat. 1491; Apr. 7, 1938, c. 108, 52 Stat. 205; Oct. 9, 1940, c. 786, § 1, 54 Stat. 1059; Aug. 28, 1954, c. 1041, Title VII, § 710(a), 68 Stat. 913; July 26, 1955, c. 382, § 1, 69 Stat. 375; Feb. 19, 1968, Pub.L. 90-258, § 1, 82 Stat. 26; July 23, 1968, Pub.L. 90-418, 82 Stat. 413; renumbered and amended Oct. 23, 1974, Pub.L. 93-463, Title I, § 101(a)(1), (2), Title II, §§ 201, 202, 88 Stat. 1389, 1395; Sept. 30, 1978, Pub.L. 95-405, § 2(1), 92 Stat. 865.

Section 4b, 7 U.S.C. §6b

Contracts designed to defraud or mislead; bucketing orders; buying and selling orders for commodities

It shall be unlawful (1) for any member of a contract market, or for any correspondent, agent, or employee of any member, in or in connection with any order to make, or the making of, any contract of sale of any commodity in interstate commerce, made, or to be made, on or subject to the rules of any contract market, for or on behalf of any other person, or (2) for any person, in or in connection with any order to make, or the making of, any contract of sale of any commodity for future delivery, made, or to be made, on or subject to the rules of any contract market, for or on behalf of any other person if such contract for future delivery is or may be used for (a) hedging any transaction in interstate commerce in such commodity or the products or by-products thereof, or (b) determining the price basis of any transaction in interstate commerce in such commodity, or (c) delivering any such commodity sold, shipped, or received in interstate commerce for the fulfillment thereof—

(A) to cheat or defraud or attempt to cheat or defraud such other person;

(B) willfully to make or cause to be made to such other person any false report or statement thereof, or willfully to enter or cause to be entered for such person any false record thereof;

(C) willfully to deceive or attempt to deceive such other person by any means whatsoever in regard to any such order or contract or the disposition or execution of any such order or contract, or in regard to any act of agency performed with respect to such order or contract for such person; or

(D) to bucket such order, or to fill such order by offset against the order or orders of any other person, or willfully and knowingly and without the prior consent of such person to become the buyer in respect to any selling order of such person, or become the seller in respect to any buying order of such person.

Nothing in this section or in any other section of this chapter shall be construed to prevent a futures commission merchant or floor broker who shall have in hand, simultaneously, buying and selling orders at the market for different principals for a like quantity of a commodity for future delivery in the same month, from executing such buying and selling orders at the market price: *Provided,* That any such execution shall take place

on the floor of the exchange where such orders are to be executed at public outcry across the ring and shall be duly reported, recorded, and cleared in the same manner as other orders executed on such exchange: *And provided further*, That such transactions shall be made in accordance with such rules and regulations as the Commission may promulgate regarding the manner of the execution of such transactions.

As amended Feb. 19, 1968, Pub.L. 90–258, § 5, 82 Stat. 27; Oct. 23, 1974, Pub.L. 93–463, Title IV, § 405, 88 Stat. 1413.

Section 14, 7 U.S.C. §18

Complaints against registered persons—Petition

(a) Any person complaining of any violation of any provision of this chapter or any rule, regulation, or order thereunder by any person who is registered or required to be registered under section 6d, 6e, 6j, or 6m of this title may, at any time within two years after the cause of action accrues, apply to the Commission by petition, which shall briefly state the facts, whereupon, if, in the opinion of the Commission, the facts therein contained warrant such action, a copy of the complaint thus made shall be forwarded by the Commission to the respondent, who shall be called upon to satisfy the complaint, or to answer it in writing, within a reasonable time to be prescribed by the Commission.

Investigation and hearing

(b) If there appear to be, in the opinion of the Commission, any reasonable grounds for investigating any complaint made under this section, the Commission shall investigate such complaint and may, if in its opinion the facts warrant such action, have said complaint served by registered mail or by certified mail or otherwise on the respondent and afford such person an opportunity for a hearing thereon before an Administrative Law Judge designated by the Commission in any place in which the said person is engaged in business: *Provided*, That in complaints wherein the amount claimed as damages does not exceed the sum of $5,000 a hearing need not be held and proof in support of the complaint and in support of the respondent's answer may be supplied in the form of depositions or verified statements of fact.

Determination

(c) After opportunity for hearing on complaints where the damages claimed exceed the sum of $5,000 has been provided or waived and on complaints where damages claimed do not exceed the sum of $5,000 not requiring hearing as provided herein, the Commission shall determine whether or not the respondent has violated any provision of this chapter or any rule, regulation, or order thereunder.

Bond requirement when complainant is nonresident; waiver

(d) In case a complaint is made by a nonresident of the United States, the complainant shall be required, before any formal action is taken on his complaint, to furnish a bond in double the amount of the claim conditioned upon the payment of costs, including a reasonable attorney's fee for the respondent if the respondent shall prevail, and any reparation

award that may be issued by the Commission against the complainant on any counterclaim by respondent: *Provided*, That the Commission shall have authority to waive the furnishing of a bond by a complainant who is a resident of a country which permits the filing of a complaint by a resident of the United States without the furnishing of a bond.

Reparations

(e) If after a hearing on a complaint made by any person under subsection (a) of this section, or without hearing as provided in subsections (b) and (c) of this section, or upon failure of the party complained against to answer a complaint duly served within the time prescribed, or to appear at a hearing after being duly notified, the Commission determines that the respondent has violated any provision of this chapter, or any rule, regulation, or order thereunder, the Commission shall, unless the offender has already made reparation to the person complaining, determine the amount of damage, if any, to which such person is entitled as a result of such violation and shall make an order directing the offender to pay to such person complaining such amount on or before the date fixed in the order. If, after the respondent has filed his answer to the complaint, it appears therein that the respondent has admitted liability for a portion of the amount claimed in the complaint as damages, the Commission under such rules and regulations as it shall prescribe, unless the respondent has already made reparation to the person complaining, may issue an order directing the respondent to pay to the complainant the undisputed amount on or before the date fixed in the order, leaving the respondent's liability for the disputed amount for subsequent determination. The remaining disputed amount shall be determined in the same manner and under the same procedure as it would have been determined if no order had been issued by the Commission with respect to the undisputed sum.

Enforcement of reparation award

(f) If any person against whom an award has been made does not pay the reparation award within the time specified in the Commission's order, the complainant, or any person for whose benefit such order was made, within three years of the date of the order, may file a certified copy of the order of the Commission, in the district court of the United States for the district in which he resides or in which is located the principal place of business of the respondent, for enforcement of such reparation award by appropriate orders. The orders, writs, and processes of such district court may in such case run, be served, and be returnable anywhere in the United States. The petitioner shall not be liable for costs in the district court, nor for costs at any subsequent state of the proceedings, unless they accrue upon his appeal. If the petitioner finally prevails, he shall be allowed a reasonable attorney's fee, to be taxed and collected as a part of the costs of the suit. Subject to the right of appeal under subsection (g) of this section, an order of the Commission awarding reparations shall be final and conclusive.

Review

(g) Any order of the Commission entered hereunder shall be reviewable on petition of any party aggrieved thereby, by the United States Court of Appeals for any circuit in which a hearing was held, or if no hearing was held, any circuit in which the appellee is located, under the procedure provided in section 9 of this title. Such appeal shall not be effective unless within 30 days from and after the date of the reparation order the appellant also files with the clerk of the court a bond in double the amount of the reparation awarded against the appellant conditioned upon the payment of the judgment entered by the court, plus interest and costs, including a reasonable attorney's fee for the appellee, if the appellee shall prevail. Such bond shall be in the form of cash, negotiable securities having a market value at least equivalent to the amount of bond prescribed, or the undertaking of a surety company on the approved list of sureties issued by the Treasury Department of the United States. The appellee shall not be liable for costs in said court. If the appellee prevails, he shall be allowed a reasonable attorney's fee to be taxed and collected as a part of his costs.

Penalty

(h) Unless the registrant against whom a reparation order has been issued shows to the satisfaction of the Commission within fifteen days from the expiration of the period allowed for compliance with such order that he has either taken an appeal as herein authorized or has made payment in full as required by such order, he shall be prohibited from trading on all contract markets and his registration shall be suspended automatically at the expiration of such fifteen-day period until he shows to the satisfaction of the Commission that he has paid the amount therein specified with interest thereon to date of payment: *Provided*, That if on appeal the appellee prevails or if the appeal is dismissed the automatic prohibition against trading and suspension of registration shall become effective at the expiration of thirty days from the date of judgment on the appeal, but if the judgment is stayed by a court of competent jurisdiction the suspension shall become effective ten days after the expiration of such stay, unless prior thereto the judgment of the court has been satisfied.

Effective date

(i) The provisions of this section shall not become effective until fifteen months after October 23, 1974: *Provided*, That claims which arise within one year immediately prior to the effective date of this section may be heard by the Commission after such fifteen months period. Sept. 21, 1922, c. 369, § 14, as added Oct. 23, 1974, Pub.L. 93-463, Title I, § 106, 88 Stat. 1393, and amended Apr. 16, 1975, Pub.L. 94-16, § 3, 89 Stat. 77; Sept. 30, 1978, Pub.L. 95-405, § 21, 92 Stat. 875.

COMMODITY FUTURES TRADING COMMISSION
REG. § 180.3, 17 C.F.R. § 180.3

Voluntary procedure and compulsory payments.

(a) The use by customers of the dispute settlement procedures established by contract markets pursuant to the Act or this Part or of the arbitration or other dispute settlement procedures specified in an agreement under paragraph (b)(3) of this section shall be voluntary. The procedures so established shall prohibit any agreement or understanding pursuant to which customers of members of the contract market agree to submit claims or grievances for settlement under said procedures prior to the time when the claim or grievance arose, except in accordance with paragraph (b) of this section.

(b) No futures commission merchant, floor broker or associated person shall enter into any agreement or understanding with a customer in which the customer agrees, prior to the time the claim or grievance arises, to submit such claim or grievance to any settlement procedure except as follows:

(1) Signing the agreement must not be made a condition for the customer to utilize the services offered by the futures commission merchant, floor broker or associated person;

(2) If the agreement is contained as a clause or clauses of a broader agreement, the customer must separately endorse the clause or clauses containing the cautionary language and other provisions specified in this section;

(3) The agreement may not require the customer to waive the right to seek reparations under section 14 of the Act and Part 12 of these regulations. Accordingly, the customer must be advised in writing that he or she

may seek reparations under section 14 of the Act by an election made within 45 days after the futures commission merchant, floor broker or associated person notifies the customer that arbitration will be demanded under the agreement. This notice must be given at the time when the futures commission merchant, floor broker or associated person notifies the customer of an intention to arbitrate. The customer must also be advised that if he or she seeks reparations under section 14 of the Act and the Commission declines to institute reparation proceedings, the claim or grievance will be subject to the preexisting arbitration agreement and must also be advised that aspects of the claims or grievances that are not subject to the reparations procedure (i.e. do not constitute a violation of the Act or rules thereunder) may be required to be submitted to the arbitration or other dispute settlement procedure set forth in the preexisting arbitration agreement.

(4) The customer agreement must contain cautionary language, printed in large boldface type, to the following effect:

WHILE THE COMMODITY FUTURES TRADING COMMISSION (CFTC) RECOGNIZES THE BENEFITS OF SETTLING DISPUTES BY ARBITRATION, IT REQUIRES THAT YOUR CONSENT TO SUCH AN AGREEMENT BE VOLUNTARY. YOU NEED NOT SIGN THIS AGREEMENT TO OPEN AN ACCOUNT WITH [name]. See 17 CFR 180.1-180.6.

BY SIGNING THIS AGREEMENT, YOU MAY BE WAIVING YOUR RIGHT TO SUE IN A COURT OF LAW, BUT YOU ARE NOT WAIVING YOUR RIGHT TO ELECT AT A LATER DATE TO PROCEED PURSUANT TO SECTION 14 OF THE COMMODITY EXCHANGE ACT TO SEEK DAMAGES SUSTAINED

AS A RESULT OF A VIOLATION OF THE ACT. IN THE EVENT A DISPUTE ARISES, YOU WILL BE NOTIFIED IF [name] INTENDS TO SUBMIT THE DISPUTE TO ARBITRATION. IF YOU BELIEVE A VIOLATION OF THE COMMODITY EXHANGE ACT IS INVOLVED AND IF YOU PREFER TO REQUEST A SECTION 14 "REPARATIONS" PROCEEDING BEFORE THE CFTC, YOU WILL STILL HAVE 45 DAYS IN WHICH TO MAKE THAT ELECTION.

(5) If the agreement specifies a forum for settlement other than a procedure established pursuant to section 5a(11) of the Act or this Part, the procedures of such forum must comply with the requirements of § 180.5.

(c) The procedure established by a contract market pursuant to section 5a(11) of the Act or this Part may require parties utilizing such procedure to agree, under applicable state law, submission agreement or otherwise, to be bound by an award rendered in the procedure, provided that the agreement to submit the claim or grievance to the procedure was made in accordance with paragraph (b) of this section or that the agreement to submit the claim or grievance was made after the claim or grievance arose. Any award so rendered shall be enforceable in accordance with applicable law.

(d) The procedure established by a contract market pursuant to the Act or this Part shall not establish any unreasonably short limitation period foreclosing submission of customers' claim [*sic*] or grievances or counterclaims (permitted by § 180.4 or [*sic*] this Part) by contract market members or employees thereof.

(7 U.S.C. 7a(11), 12a (Supp. V, 1975))

[41 FR 42946, Sept. 29, 1976, as amended at 42 FR 3433, Jan. 18, 1977]